No. 88-385-CFX
Status: GRANTED

Title: Ofelia Rodriguez de Quijas, et al., Petitioners
v.
Shearson/American Express, Inc., etc.

Docketed:
September 1, 1988

Court: United States Court of Appeals
for the Fifth Circuit

See also:
88-284

Counsel for petitioner: Downey,Denis A.

Counsel for respondent: Friedman,Jeffrey L.,
Krebsbach,Theodore A.

Entry	Date	Note	Proceedings and Orders
1	Sep 1 1988	G	Petition for writ of certiorari filed.
3	Sep 14 1988		Order extending time to file response to petition until October 20, 1988.
4	Oct 20 1988		Brief amicus curiae of Securities Industry Assn. filed.
5	Oct 20 1988		Brief of respondent Shearson/American Express in opposition filed.
6	Oct 26 1988		DISTRIBUTED. November 10, 1988
7	Nov 14 1988		Petition GRANTED.
			**********
9	Dec 13 1988		Order extending time to file brief of petitioner on the merits until January 9, 1989.
12	Dec 23 1988		Order extending time to file brief of respondent on the merits until February 20, 1989.
10	Dec 29 1988		Joint appendix filed.
13	Jan 9 1989		Brief of petitioner Ofelia Rodriguez de Quijas filed.
14	Jan 31 1989		Record filed.
		*	Certified copy of original record and proceedings, 9 volumes, received.
15	Feb 3 1989		SET FOR ARGUMENT MONDAY, MARCH 27, 1989. (1ST CASE)
16	Feb 16 1989		Brief of respondent Shearson/American Express filed.
18	Feb 17 1989	X	Brief amici curiae of Securities Industry Assn. filed.
17	Feb 21 1989		CIRCULATED.
19	Mar 17 1989	X	Reply brief of petitioner Ofelia Rodriguez de Quijas filed.
20	Mar 20 1989		Lodging received.
21	Mar 27 1989		ARGUED.

(1)

88-385

No. 88-

Supreme Court, U.S.
FILED
SEP 1 1988
JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1988

OFELIA RODRIGUEZ DE QUIJAS, ET AL.,
Petitioners,

VS.

SHEARSON/AMERICAN EXPRESS, INC., ITS SUCCESSORS AND ASSIGNS,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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31 August, 1988

E. L. MENDENHALL, INC., 926 Cherry Street, Kansas City, Mo. 64106, (816) 421-3033

QUESTION PRESENTED

1. Are claims under § 12(2) of the 1933 Securities Act now arbitrable under predispute broker contracts?

2. If such claims are now arbitrable, may these Petitioners be compelled to submit such claims to arbitration pursuant to terms of a predispute contract executed at a time when § 12(2) claims were clearly not subject to arbitration?

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No. 88-

In the Supreme Court of the United States

OCTOBER TERM, 1988

OFELIA RODRIGUEZ DE QUIJAS, ET AL.,
Petitioners,

VS.

SHEARSON/AMERICAN EXPRESS, INC., ITS SUCCESSORS AND ASSIGNS,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REFERENCE TO OPINIONS

The opinion of the United States Court for the Southern District of Texas, Brownsville Division, dated November 18, 1986, directed to arbitration all claims of Petitioners[1] except their § 12(2) claims under the 1933 Securities Act.

The opinion of the United States Court of Appeals for the Fifth Circuit reversed the district court and held that § 12(2) claims *were* subject to arbitration.

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1. Petitioners include Ofelia Rodriguez de Quijas, Jose Luis Rodriguez, Jose Luis Rodriguez Moreno, Martha Leticia Rodriguez Moreno, Luis Alejandro Rodriguez Moreno, Beatriz Rodriguez, Mary Grace Norman, Adelina Trapero, Gene Griffin, Gertrud Griffin.

JURISDICTION

The judgment of the court of appeals was entered on June 6, 1988 and the motion for rehearing denied on June 22, 1988. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1). The district court exercised jurisdiction pursuant to 15 U.S.C. § 77v, 15 U.S.C. § 78aa, 15 U.S.C. § 80b-14, 18 U.S.C. § 1964, 28 U.S.C. § 1332(a)(1).

STATUTES INVOLVED

Section 14 of the 1933 Securities Act, 15 U.S.C § 77n, provides in pertinent part that:

> "Any condition, stipulation or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."

Section 12(2), 15 U.S.C. § 77l(2), provides in pertinent part that:

Any person who—

* * *

> (2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,
>
> shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction . . .

The Federal Arbitration Act, 9 U.S.C. § 2, provides in pertinent part that:

> ". . . an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction or refusal shall be valid, irrevocable, and enforceable save upon such grounds as exist at law or in equity for the revocation of any contract."

STATEMENT OF THE CASE

Petitioners are members of a group of some seventeen first-time investors, the majority of whom were minors, widows, individuals dying of cancer, or individuals unable to understand English. All signed standard-form brokerage house contracts which were typically presented face down in a fashion which obscured arbitration clauses. Most were denied copies of the documents signed. Such individuals alleged that an employee of Shearson/American Express defrauded each. Pursuant to the motions of Defendant Shearson/American Express, all claims except § 12(2) claims were ordered submitted to arbitration. On the basis of *Shearson/American Express, Inc. v. McMahon*, 96 L.Ed.2d 185 (1987), the 5th Circuit Court of Appeals thereafter reversed the District Court on the § 12(2) arbitrability issue holding that such claims were arbitrable.

REASONS FOR GRANTING THE WRIT

THE DECISION BELOW CONFLICTS WITH THE RELEVANT OPINIONS OF THIS COURT, WITH THE DECISIONS OF OTHER CIRCUIT AND STATE COURTS WHICH HAVE CONSIDERED THE ISSUE, AND WITH RECENT EXPRESSION OF CONGRESSIONAL INTENT.

1. The petition should be granted because the court of appeals failed to follow this Court's decision in *Wilco v. Swan*, 346 U.S. 427 (1953), which held that § 12(2) claims under the 1933 Securities Act were not subject to compulsory predispute arbitration terms. In *Wilco*, a seven justice majority determined that a predispute agreement to arbitrate § 12(2) claims were not enforceable because of Congressional intent. Despite this Court's refusal to overrule its prior *Wilco* opinion in *Shearson/American Express, Inc. v. McMahon*, 96 L.Ed.2d 185 (1987), the 5th Circuit Court of Appeals held here, and without referring to *Chang v. Lin*, 824 F.2d 219 (2nd Cir. 1987), that a predispute agreement to arbitrate Petitioners' § 12 (2) claims *was* enforceable.

2. The writ should also be granted because this court of appeals' decision conflicts with another federal court of appeals' decision, *Chang v. Lin*, 824 F.2d 219 (2nd Cir. 1987) as well as numerous lower federal and state court decisions.

3. Additionally, Congress, after conducting hearings with respect to proposed amendments to the 1934 Securities & Exchange Act, has now proposed H.R. 4960 (100th Congress, 2nd Session) which specifically addresses *McMahon*. Such legislation does not propose parallel arbitration changes to the 1933 Act, strongly suggesting again, as in 1975, a Congressional endorsement of *Wilco*.

4. Finally the writ should be granted because it is inappropriate for a court of appeals to, in effect, overrule clear Supreme Court precedent. See *Thurtson Motor Lines, Inc. v. Jordan K. Rand, Ltd.*, 460 U.S. 533, 535 (1983). That is more so the case when the Supreme Court has itself recently declined to alter its own precedent as was the case in *McMahon*.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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31 August, 1988

APPENDIX

(Filed November 18, 1986)

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
BROWNSVILLE DIVISION

C. A. NO. B-85-360

OFELIA RODRIGUEZ DE QUIJAS, ET AL.

VS.

SHEARSON/AMERICAN EXPRESS, INC. Its Successors and Assigns, and JON GRADY DEATON, Jointly and Severally

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MEMORANDUM AND ORDER

FACTS

In August of 1985, Plaintiffs Ofelia Rodriguez de Quijas, *et al.* brought suit against Defendants Shearson/American Express and Jon Grady Deaton based upon a series of transactions involving the financial management of separate accounts totalling approximately $190,000. Plaintiffs allege that Defendant Deaton, the manager of the discretionary account with Shearson, fraudulently induced the Plaintiffs to enter into the investment contract. Additionally, it is alleged that Defendants conducted a number of unauthorized and/or fraudulent transactions and misrepresented to Plaintiffs the nature of these transactions. These transactions, it is asserted, were designed

to generate commissions and profits for Defendants and resulted in staggering losses for the Plaintiffs. Plaintiffs bring this action under sections 12(2) and 17(a) of the 1933 Federal Securities Act and sections 10(b) (and rule 106-5 thereunder), 15(c)(1), 15(c)(2) of the Securities Exchange Act of 1934 (and rules 15c1-2, 15c1-4, 15c1-6, thereunder). Plaintiffs also assert civil RICO claims based upon predicate acts of mail and wire fraud, in violation of 18 U.S.C. § 1341, § 1343, and § 1961, as well as acts of securities fraud in violation of TEX. CIV. ART. 581-33(A)(2), claims under the Texas Deceptive Trade Practices Act, TEX. BUS. & COM. CODE ANN. § 17.46 *et seq.* (Vernon 1986), and common law breach of contract, fraud, and misrepresentation.

Defendants have filed a Motion to Compel Arbitration of all the claims arising out of transactions in question pursuant to an arbitration clause in the investment contracts signed by the Plaintiffs. The Court must now decide which of the claims must be arbitrated.

A) *The Arbitration Clause*

The question whether arbitration is controlling is determined on the basis of the existence of an arbitration clause that on its face appears broad enough to encompass the parties' claims. *Mar-Len of LA., Inc. v. Parsons-Gilbane*, 773 F.2d 633, 635 (5th Cir. 1985); *Commerce Park at DFW Freeport v. Mardian Construction Co.*, 729 F.2d 334, 338 (5th Cir. 1984). The Fifth Circuit in *Commerce Park* reasoned that when confronted with an arbitration clause, a presumption arises that arbitration should not be denied "unless it can be said with positive assurance that an arbitration clause is not susceptible of an interpretation which would cover the dispute at issue." *Id. quoting Wick*

v. Atlantic Marine, Inc., 605 F.2d 166, 168 (5th Cir. 1979). Thus, as a general rule, whenever the scope of an arbitration clause is in question, the court should construe the clause in favor of arbitration. *United Steelworkers of America v. Warrior & Gulf Navigational Co.*, 363 U.S. 574, 583, 80 S.Ct. 1347, 1353, 4 L.Ed.2d 1409 (1960). The Court, after reviewing the arbitration clause in this case, is of the opinion that it is more than sufficiently broad to cover all the claims involved in this cause of action.[1]

The Plaintiffs contend that the arbitration clause was fraudulently induced and thus cannot control the disposition of this case. In *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395, 87 S.Ct. 1801, 18 L.Ed. 2d 1270 (1967), the United States Supreme Court dealt with the issue of whether fraudulent inducement can be brought before an arbitrator instead of district court. The Supreme Court reasoned that:

> If the claim is fraud in the inducement of the arbitration clause itself - an issue which goes to the 'making' of the agreement to arbitrate - the federal court *may* proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement generally . . . [A] federal

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1. The arbitration agreement in paragraph 13 reads as follows:

> "Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules then in effect, of the National Association of Securities Dealers, Inc. as I may elect. If I do not make my election by registered mail addressed to you at your main office within 5 days after demand by you that I make such election, then you may make such election. Judgment upon any award rendered by the arbitration may be entered in any court having jurisdiction thereof."

court may consider only issues relating to the making and performance of the agreement to arbitrate.

Id. at 403-04, 87 S.Ct. at 1805-06.

The Seventh Circuit in *Schacht v. Beacon Ins. Co.*, 742 F.2d 386, 389 (7th Cir. 1984), reaffirmed this position and noted that only when the claimed contractual invalidity goes to the arbitration clause itself does the court decide the existence of a contractual provision. *See also Mar-Len of LA., Inc. v. Parsons-Gilbane*, 773 F.2d 633 (1985) (alleging fraud in the inducement of a modification to the original contract).

Although Plaintiffs, in their brief in Opposition to Motions to Dismiss and Compel Arbitration, purport to allege only fraud in the inducement of the arbitration clause itself, the Court sees nothing before it which would lead the Court to believe the alleged fraud in the inducement applied solely to the arbitration clause. To the contrary, in all the Plaintiffs' Affidavits in Opposition to Defendants' Motion to stay, they stated that the "contracts" were not explained to them, and that they could not understand the technical Shearson "contract"; not just the arbitration clause. The Court believes that Plaintiffs cannot avoid the application of *Prima Paint* by simply alleging the fraud on the clause itself when the substance of the complaint reveals fraud on the whole contract. Accordingly, Plaintiffs' claim of fraud in the inducement must be resolved in the arbitral forum.

B) *The Securities Act Claims*

In *Wilco v. Swan*, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1958), the United States Supreme Court held that predispute agreements to arbitrate claims that arise under

Securities Act of 1933 are not enforceable. The Court pointed to language in § 14 of the Securities Act of 1933, 15 U.S.C. § 77n, which declared "void" any "stipulation" waiving compliance with any "provision" of the Securities Act. The Supreme Court thus held that an agreement to arbitrate amounted to a stipulation waiving the right to seek a judicial remedy, and was therefore void. 346 U.S. at 434-435. Subsequent court decisions have preserved the vitality of this Supreme Court holding. *See Dean Witter Reynolds, Inc. v. Byrd*, 105 S.Ct. 1238, 1240 n.1 (1985); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823, 826-827 (10th Cir. 1979); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831 (7th Cir. 1977). Accordingly, the 1933 Securities Act claims cannot be arbitrated.

Although Defendants would fail on the 1933 Act claim, they would assert that the claims arising under § 10(b) of the Securities Exchange Act of 1934 are distinguishable and should not be governed by the *Wilco v. Swan* holding. In *Scherk v. Alberto Culvert Company*, 417 U.S. 506, 94 S.Ct. 2449, 41 L.Ed.2d 270 (1974), the Supreme Court failed to extend *Wilco* to § 10(b) claims. The Court stated that the provisions of the 1934 Act differed from those of the 1933 Act and thus the reasoning of *Wilco* was inapplicable.[2] Recently, in *Dean Witter Reynolds, Inc. v. Byrd*, 105 S.Ct. 1238 (1985), Justice White, in his concurrence, resurfaced the apparent

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2. The Supreme Court questioned the applicability of *Wilco* to a claim arising under § 10(b) of the Securities Exchange Act of 1934 because unlike the 1933 Act, the 1934 Act did not expressly give rise to a private cause of action. Additionally, since a cause of action under § 10(b) and Rule 106-5 is implied rather than express, the "waiver" provision under the 1933 Act would not be literally applicable.

difference between the two Acts but the Supreme Court's majority declined to directly resolve the question.

Notwithstanding the doubts raised by the Supreme Court, the case law in the Fifth Circuit is clear on the issue of the arbitrability of the 1934 Act. The Court has consistently held that Congress intended these claims to be non-arbitrable. *See, e.g., Mayaja, Inc. v. Bodkin, et al.*, No. 85-2762, slip op. 671, 679 (5th Cir. October 17, 1986); *Bustamante v. Rotan Mosle, Inc.*, No. 86-2300, slip op. 339, 340 (5th Cir. October 17, 1986); *Smokey Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 785 F.2d 1274, 1275 n.1 (5th Cir. 1986); *Sibley v. Tandy Corp.*, 543 F.2d 540, 543 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977). Basing their decisions upon an extension of the Supreme Court's analysis in *Wilco v. Swan*, these opinions adhered to the view that the similarities between the 1933 Securities Act and the 1934 Exchange Act far outweighed any differences that might exist.

Additionally, Defendants would assert that the recent Supreme Court decision in *Mitsubishi Motors Corp. v. Solar Chrysler-Plymouth, Inc.*, 105 S.Ct. 3346 (1985) would diminish the vitality of its holding in *Wilco* and implicitly overrule the established precedent in the Fifth Circuit. Presented with this argument in *Mayaja, Inc. v. Bodkin, et al.*, No. 85-2762, slip op. 671 (5th Cir. October 24, 1986), the Fifth Circuit declined to give it much consideration. Instead, it elected to follow the established precedent in the Circuit and held, absent a clearer statement from the Supreme Court on the issue, that the 1934 Exchange Act claims are not arbitrable. *Id.* at 679. This Court must follow the precedent set forth

by the Fifth Circuit and rule that both the 1933 Securities Act claims and the 1934 Exchange Act claims are not arbitrable. Therefore, solely with regard to these claims, the Defendant's Motion to Compel Arbitration is hereby DENIED.

C) *The RICO Claims*

The question of whether private RICO claims may be arbitrated is the subject of a split of authority among the Circuit Courts. The Second Circuit, in *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986), *cert. granted*, 55 U.S.L.W. 3197 (U.S. Oct. 6, 1986) (86-44), held that no RICO claims were ever arbitrable, regardless of the predicate offenses asserted. The Third Circuit, in contrast, held in *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197 (3rd Cir. 1986) that RICO claims may be arbitrated when the offenses predicate to the required "pattern of racketeering activity" are arbitrable.[3] The Fifth Circuit, until its recent decision in *Mayaja, Inc. v. Bodkin*, No. 85-2762, slip op. 671 (5th Cir. October 24, 1986), had not expressly ruled on the issue.[4] In the decision, the Fifth

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3. Therefore, if the Third Circuit were controlling, and the predicate offenses alleged were separate acts of wire and mail fraud, the RICO claims founded under 18 U.S.C. § 1341 and § 1342 would be arbitrable. If, however, the Securities Act violations were the predicate offenses alleged, the claims would be non-arbitrable pursuant to *Wilco v. Swan* and subsequent decisions. *Supra.*

4. In *Smokey Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 785 F.2d 1274, 1280-82 (5th Cir. 1986), the Fifth Circuit addressed, in dicta, the issue of arbitrability of private RICO claims. On petition for rehearing en banc, the Court noted that its reasoning was called into question by *Mitsubishi*. The Court thereafter amended its opinion "to refuse to decide the arbitrability *vel non* of the plaintiff's RICO claim." *Id.* at 1282.

Circuit held that private RICO claims must be submitted to arbitration if a valid clause encompasses the claims. *Id.*

In order for a statutory claim like the civil RICO statute to overcome the overriding federal policy in favor of arbitration, it is necessary to show that Congress intended the statutory claim to be non-arbitrable. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983). In reaching its decision in *Mayaja, Inc.*, the Panel relied on the legislative history of the civil RICO statute; specifically, section 1964(c), the treble damages provision. Finding nothing in the express intent of Congress, the Panel examined the underlying purpose of the statute to determine whether Congress implicitly intended that all such claims be non-arbitrable. The Panel then relied on the Supreme Court's examination in *Mitsubishi* of section 4 of the Clayton Act.[5] 105 S.Ct. at 3358-60. The Panel agreed with the Supreme Court's assessment that the treble damages provision served a crucial deterrent function. In citing *Mitsubishi* at 3359, however, they found that the "action . . . seeks *primarily* to enable an injured competitor to gain compensation for that injury." Therefore, since the deterrent function was secondary to the compensatory function, the statute would continue to serve both its remedial and deterrent functions "so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum." *Mayaja, Inc. v. Bodkin*, No. 85-2762, slip op. 671 (5th Cir. October 24, 1986) *citing Mitsubishi*, 105 S.Ct. at 3359-60. Having paralleled *Mitsubishi's* analysis, the Panel found that the congressional purposes of compensation and deterrence underlying section 1964 (c) may be fulfilled by arbitration of the RICO claims. Thus, there was no evidence that Congress implied that all RICO claims were non-arbitrable.

5. The Panel reasoned that since the legislative history of section 1964(c) made repeated references to section 4 of the Clayton Act, these references to the Clayton Act could be adopted by reference to the purposes of the Clayton Act's treble damages provision.

Following the precedent set forth in *Mayaja, Inc.*, the Court accordingly rules that Plaintiffs' RICO claims are arbitrable and that the Defendants' Motion to Compel Arbitration of these claims is hereby GRANTED.

D) *The Deceptive Trade Practices Act Claim*

There is no Texas case law authority which would definitively determine whether Plaintiffs' case under the Texas Deceptive Trade Practices Act can or cannot be arbitrated. However, in *Ommani v. Doctor's Associates, Inc.*, 789 F.2d 298, 300 (5th Cir. 1986), the Fifth Circuit stated that enforcement of an otherwise valid arbitration clause cannot be denied solely by virtue of the suggestion that a claim is also based on the Texas Deceptive Trade Practices Act. The Panel cited the U.S. Supreme Court decision in *Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852, 79 L.Ed.2d 1 (1984) for the proposition that states may not thwart the strong federal policy favoring arbitration. Although these statements are rather broad, the Court is persuaded that the Deceptive Trade claims can be arbitrated under the Federal Arbitration Act. Absent any clear Texas authority to the contrary, this Court is compelled to do so.[6] *See also Marley v.*

6. Plaintiffs assert the novel argument that the contract provision in this case is self-limiting and the federal preemp-

(Continued on following page)

Drexel Burnham, Inc., 566 F.Supp. 333 (N.D. Tex. 1983). Therefore, the Defendants' Motion to Compel Arbitration of the Texas Deceptive Trade Practices Act is hereby GRANTED.

E) *Motion To Dismiss The Section 17(a) Claims*

Although the Supreme Court has not ruled on the issue, the Fifth Circuit has clearly held that there is no private cause of action under Section 17(a) of the Securities Exchange Act of 1933. *Landry v. All American Assurance Company*, 688 F.2d 381 (5th Cir. 1982. The Court therefore concludes that Defendants' Motion to Dismiss under Rule 12(b)(6) (failure to state a claim upon which relief can be granted) is hereby GRANTED and the claims under § 17 be DISMISSED.

F) *The Stay Issue*

The Court hereby ORDERS that the non-arbitrable Securities Act claims proceed under this cause of action and those claims will not be stayed pending resolution of the arbitrable claims. *See Dean Witter Reynolds, Inc. v. Byrd*, 105 S.Ct. at 1245 (1985). Therefore, the Defendants' Motion to Stay Pending Arbitration will be DENIED with regard to the Securities Act claims. As only the Securities Act claims remain before this Court, all other claims asserted by Plaintiffs will be presented in arbitration.

Footnote continued—

tion doctrine would not be controlling. The relevant provision states: "Unless unenforceable due to federal or state law, any controversy . . . shall be settled by arbitration." Even if the arbitration would be unenforceable under Texas law, the Court cannot concede that the provisions in the language of this contract would override the Federal Arbitration Act.

It is so ORDERED.

DONE at Brownsville, Texas this 18th day of November, 1986.

/s/ Filemon B. Vela
Filemon B. Vela
United States District Judge

Ofelia RODRIGUEZ De QUIJAS, et al.,
Plaintiffs-Appellees,

v.

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a Shearson/American Express, Inc., and
Jon Grady Deaton,
Defendants-Appellants.

Mary Grace NORMAN,
Plaintiff-Appellee,

v.

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a Shearson/American Express,
Inc., etc., et al.,
Defendants-Appellants.

Adelina TRAPERO,
Plaintiff-Appellee,

v.

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a Shearson/American Express, Inc., Its
Successors and Assigns, and Jon Grady
Deaton, Jointly and Severally,
Defendants-Appellants.

Gene GRIFFIN and Gertrud Griffin,
Plaintiffs-Appellees,

v.

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a Shearson/American Express,
Inc., etc., et al.,
Defendants-Appellants.

Nos. 87-2888 to 87-2891.

United States Court of Appeals,
Fifth Circuit.

May 31, 1988.

Securities firm appealed from order of the United States District Court for the Southern District of Texas, Filemon B. Vela, J., which refused to order arbitration of claims under the Securities Act. The Court of Appeals, Jerre S. Williams, Circuit Judge, held that claims under § 12(2) of the Securities Act are subject to predispute arbitration agreements.

Reversed.

1. Exchanges (Key) 11(11)

Claims under § 12(2) of the Securities Act are subject to predispute arbitration agreements. Securities Act of 1933, § 12(2), 15 U.S.C.A. § 77*l*(2).

2. Exchanges (Key) 11(11)

Fact that, under Supreme Court precedent Securities Act claims were not subject to arbitration at time that arbitration agreement was signed between securities firm and customer did not mean that customers lacked the intent to arbitrate when they signed it so as to preclude arbitration of their claims under the Securities Act. Securities Act of 1933, § 12(2), 15 U.S.C.A. § 77*l*(2).

Appeals from the United States District Court for the Southern District of Texas.

Before THORNBERRY, WILLIAMS and DAVIS, Circuit Judges.

JERRE S. WILLIAMS, Circuit Judge:

In these consolidated cases we confront the issue of whether claims brought under § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2) (1982), are subject to predispute arbitration agreements. This issue arises in the wake of *Shearson/American Express, Inc. v. McMahon*, ... U.S. ....., 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987), which enforced a predispute agreement to arbitrate § 10 (b) claims under the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982). We find § 12(2) claims to be arbitrable, notwithstanding the earlier precedent of *Wilko v. Swan*, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953).

I.

Appellees are individual investors in Brownsville, Texas, who suffered financial losses as the alleged result of unauthorized, fraudulent transactions in securities. Approximately $190,000 was invested by the Rodriguez De Quijas family; $38,000 by Mary Grace Norman; $100,000 by Adelina Trapero; and $80,000 by Gene and Gertrud Griffin. They sued appellants Jon Grady Deaton, the agent in charge of the accounts, and Shearson/American Express, Inc. ("Shearson"), pleading violations of various state and federal laws.[1] Appellant Shearson

1. Their common claims include violations of §§ 12(2) and 17(a) of the 1933 Securities Act, and §§ 10(b), 15(c)(1), 15(c)(2) of the Securities Exchange Act of 1934; civil RICO violations consisting of mail and wire fraud under 18 U.S.C. §§ 1341, 1343, and 1961 (1982); securities fraud in violation of TEX.REV.CIV.STAT.ANN. § 581-33(A)(2) (Vernon 1964);

(Continued on following page)

moved to compel arbitration pursuant to an arbitration clause contained in the customer agreements signed by each appellee,[2] and in accordance with the Federal Arbitration Act.[3] The district court ordered arbitration of all claims except for the federal securities claims.

Footnote continued—

violations of the Texas Deceptive Trade Practices Act, TEX. BUS. and COMM. CODE ANN. § 17.46 *et seq.* (Vernon 1986); and common law breach of contract, fraud, and misrepresentation. The district court properly dismissed appellees' Securities Act § 17(a) claims under Fed.R.Civ.P. 12(b)(6), because this Court has held that there is no such private cause of action. *Landry v. All American Assurance Co.*, 688 F.2d 381 (5th Cir.1982).

2. Paragraph 13 of the Customer's Agreement provides:

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, the transactions with you for me, or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules then in effect of the National Association of Securities Dealers, Inc., or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I may elect. If I do not make such election by registered mail addressed to you at your main office within five (5) days after demand by you that I make such election then you may make such election. Judgment upon any award ordered by the arbitrators may be entered in any court having jurisdiction thereof.

3. The Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* (1982) ("FAA"), mandates enforcement of agreements to arbitrate. *E.g., Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983). The FAA states in pertinent part:

> § 2. Validity, irrevocability, and enforcement of agreements to arbitrate
>
> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration on a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part, thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

The district court correctly followed the Supreme Court's decision in *Wilko v. Swan, supra*, which clearly set out the invalidity of agreements to arbitrate § 12(2) claims under the Securities Act. And until recently, *Wilko* was interpreted in this Circuit as barring arbitration of Securities Exchange Act claims as well. *E.g. Mayaja, Inc. v. Bodkin*, 803 F.2d 157 (5th Cir.1986), *cert. denied in part* ..... U.S. ....., 107 S.Ct. 3210, 96 L.Ed.2d 697 (1987) *vacated in part*, ... U.S. ....., 107 S.Ct. 3205, 96 L.Ed.2d 692 (1987); *Bustamante v. Rotan Mosle, Inc.*, 802 F.2d 815 (5th Cir.1986); *King v. Drexel Burnham Lambert, Inc.*, 796 F.2d 59 (5th Cir.1986) vacated, ... U.S. ....., 107 S.Ct. 3203, 96 L.Ed.2d 690 (1987). But the Supreme Court with *Shearson/American Express, Inc. v. McMahon, supra*, established the arbitrability of Securities Exchange Act claims. Appellant Shearson asserts this decision effectively overrules *Wilko* and allows arbitration of Securities Act claims.

Appellees do not contest the arbitrability of their Exchange Act claims following *McMahon*. They argue only that *Wilko* remains good law and prohibits arbitration of claims brought under § 12(2) of the Securities Act. Appellees argue further that even if § 12(2) claims are arbitrable, the parties lacked the requisite intent to agree to arbitration. We address these claims.

II.

The Supreme Court in *McMahon*, enforced a predispute agreement to arbitrate claims brought under § 10 (b) of the 1934 Exchange Act. *Supra*, ... U.S. at ....., 107 S.Ct. at 2343. In doing so, it refused under the 1934 Act to follow the reasoning of *Wilko v. Swan*, which invalidated predispute agreements to arbitrate 1933 Act

claims. *Wilko, supra*, at 438, 74 S.Ct. at 188-89. The *McMahon* majority opinion does not expressly overrule *Wilko;* the precise issue of the arbitrability of § 12(2) claims was not before the court.[4] Nevertheless, the reasoning in *McMahon* completely undermined *Wilko*, as this Court noted in *Noble v. Drexel Burnham Lambert, Inc.*, 823 F.2d 849, 850 n. 3. (5th Cir.1987) ("*McMahon* undercuts every aspect of *Wilko v. Swan* . . .; a formal overruling of *Wilko*, appears inevitable—or, perhaps, superfluous.").

The basic premise of *Wilko* is that a predispute agreement to arbitrate § 12(2) claims is invalid by virtue of § 14 of the Securities Act, 15 U.S.C. § 77n. (1982). Section 14 voids any stipulation "to waive compliance with any provision" of the Securities Act. The *Wilko* court held the jurisdictional provision of the Securities Act to be the type of non-waivable provision contemplated in § 14. *Wilko, supra*, 346 U.S. at 434, 74 S.Ct. at 186. The Supreme Court states in *McMahon*, however, that § 29 (a) of the Exchange Act, 15 U.S.C. § 78cc(a) (1982), which is a non-waiver provision virtually identical to § 14 of the Securities Act, does not bar predispute arbitration agreements. *McMahon, supra*, ... U.S. at ....., 107 S.Ct. at 2338-39.[5]

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4. The opinion states: "While stare decisis concerns may counsel against upsetting *Wilko's* contrary conclusion under the Security Act, we refuse to extend *Wilko's* reasoning to the Exchange Act. . . ." *McMahon, supra* ..... U.S. at ....., 107 S.Ct. at 2341.

5. The *McMahon* court reasons that § 29(a) voids only those agreements which waive "compliance" with provisions of the Exchange Act, and that because the jurisdictional provision of the Exchange Act does not impose substantive obligations with which to comply, nothing prevents its waiver. *Supra*,

(Continued on following page)

The Supreme Court reconciles *McMahon* with *Wilko* by characterizing the 1953 opinion as outdated in its bias against arbitration. The *McMahon* majority opinion reinterprets *Wilko*, as follows: "*Wilko* must be read as barring waiver of a judicial forum only where arbitration is inadequate to protect the substantive rights at issue." *McMahon, supra*, at ....., 107 S.Ct. at 2339. As *McMahon* makes clear, the Supreme Court no longer considers arbitration inadequate to protect substantive rights. *Id.*, at ....., 107 S.Ct. at 2340-41. For this proposition, the court relied upon *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614, 105 S.Ct. 3346, 87 L.Ed.2d 444 (1985); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 105 S.Ct. 1238, 84 L.Ed.2d 158 (1985); *Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852, 79 L.Ed.2d 1 (1984); *Moses H. Cone Memorial Hospital v. Mercury*

Footnote continued—

..... U.S. at ....., 107 S.Ct. at 2338. Section 27, the jurisdictional provision of the Exchange Act, 15 U.S.C. § 78aa (1982), is similar to the jurisdictional provision of the Securities Act. Section 27 of the Exchange Act states in part:

> The district courts of the United States . . . shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder.

Compare § 22(a), the jurisdictional provision of the Securities Act, 15 U.S.C. § 77v(a) (1982), which reads as follows:

> The district courts of the United States . . . shall have jurisdiction . . . concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found.

Construction Corp., 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983); and *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 94 S.Ct. 2449, 41 L.Ed.2d 270 (1974). Advances in arbitration noted by the Supreme Court, particularly the broad oversight authority of the Securities Exchange Commission, *McMahon, supra*, ... U.S. at ....., 107 S.Ct. at 2341, apply equally to the protection of substantive rights under both the Securities Act and the Exchange Act.

[1] Appellees argue, however, that congressional intent is the crucial distinction between the two Acts. They claim that Congress, by preserving *Wilko* in the 1975 revisions of the Exchange Act, manifested its intent that at least § 12(2) claims should remain non-arbitrable.[6] We find it implausible that Congress intended to prohibit arbitration of Securities Act claims but intended to allow courts to determine the arbitrability of Exchange Act claims.[7] Similarly fine distinctions between the two Acts have been presented throughout the course of the debate over securities arbitration. *See, e.g., McMahon, supra*, at ....., 107 S.Ct. at 2347 n.n. 1-2 (Blackmun J., dis-

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6. The Conference Report accompanying the amendments to § 28(b) of the Exchange Act, 15 U.S.C. § 78bb(b), reads as follows:

> It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan*, 346 U.S. 427 [74 S.Ct. 182, 98 L.Ed. 168] (1953), concerning the effect of arbitration proceedings provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations.

H.R.Conf.Rep. No. 229, 94th Cong., 1st Sess., 111 (1975), U.S. Code Cong. & Admin.News 1975, pp. 179, 342.

7. The Supreme Court states in *McMahon, supra*, ... U.S. at ....., 107 S.Ct. at 2343: "Hence, the *Wilko* issue was left to the courts; it was unaffected by the amendment to § 28(b)."

senting). We do not, however, find these asserted distinctions controlling on the issue of arbitration. The Supreme Court opinion in *McMahon*, which binds us here, turns solely on the adequacy of arbitration to resolve securities disputes. It does not distinguish between the Exchange Act and the Securities Act. Furthermore, it has been the position of this Court that, for the purposes of arbitration, similarities between the Securities Act and the Exchange Act outweigh any differences between them. *Sibley v. Tandy Corp.*, 543 F.2d 540, 543 n. 3 (1976). We thus follow the reasoning of the Supreme Court in *McMahon* and our own decision in *Noble* which lead directly to the obsolescence of *Wilko* and the arbitrability of Securities Act § 12(2) claims.

III.

[2] Appellees claim that even if § 12(2) claims are arbitrable, the intent to agree to arbitration was lacking in their cases. At the time the agreements were signed, claim appellees, Securities Act claims were controlled by *Wilko* and clearly were not subject to arbitration. We cannot conclude that appellees lacked the intent to agree to arbitration because, at the time the customer agreements were signed, courts refused to honor clauses compelling arbitration of securities claims. At the time the contracts were signed, the same circumstances existed barring arbitration of Exchange Act claims. *E.g. Sibley, supra*, at 543. Appellees cannot now contend that they lacked the intent to arbitrate their Exchange Act claims in view of the Court's holding in *McMahon*. Neither the Supreme Court nor this Circuit considered that the earlier lack of authorization to arbitrate was an obstacle in *McMahon, supra* or *Noble, supra*. Both cases ordered

arbitration of Exchange Act claims under analogous circumstances.

Authority no longer exists to deny arbitration of the § 12(2) claims as the parties agreed in their contracts. Arbitration must be directed both as to the Securities Act claims and Exchange Act claims. That portion of the judgment of the district court which denied directing arbitration of the Securities Act § 12(2) claims is

REVERSED.

(Filed June 22, 1988)

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 87-2888, 87-2889, 87-2890
& 87-2891

Opelia RODRIGUEZ De QUIJAS, et al.,
Plaintiffs-Appellees,

v.

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a Shearson/American Express, Inc., and
Jon Grady Deaton,
Defendants-Appellants.

Mary Grace NORMAN,
Plaintiff-Appellee,

v.

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a Shearson/American Express, Inc.,
etc., et al.,
Defendants-Appellants.

Adelina TRAPERO,
Plaintiff-Appellee,

v.

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a Shearson/American Express, Inc., Its
Successors and Assigns, and Jon Grady
Deaton, Jointly and Severally,
Defendants-Appellants.

Gene GRIFFIN and Gertrud Griffin,
Plaintiffs-Appellees,

v.

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a Shearson/American Express, Inc.,
etc., et al.,
Defendants-Appellants.

Appeals from the United States District Court for the
Southern District of Texas

ON PETITION FOR REHEARING

(June 22, 1988)

Before THORNBERRY, WILLIAMS and DAVIS, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby denied.

ENTERED FOR THE COURT:

/s/ J. S. Williams
United States Circuit Judge

Supreme Court, U.S.
FILED
OCT 20 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-385

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

OFELIA RODRIGUEZ DE QUIJAS, et al.,

Petitioners,

v.

SHEARSON/AMERICAN EXPRESS, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether *Shearson/American Express, Inc. v. McMahon*, 482 U.S. ____, 107 S. Ct. 2332 (1987), mandates arbitration of claims asserted under § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2) (1982), pursuant to a valid arbitration agreement?

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Section 14, 15 U.S.C. § 77n

Section 22(a), 15 U.S.C. § 77v(a)

Securities Exchange Act of 1934

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Section 29(a), 15 U.S.C. § 78cc(a)

* The text of these provisions is reproduced in full at Appendix A hereto.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-385

OFELIA RODRIGUEZ DE QUIJAS, et al.,

Petitioners,

v.

SHEARSON/AMERICAN EXPRESS, INC.,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 845 F.2d 1296, and is reproduced at Appendix B hereto. The order of the court of appeals denying petitioners' motion for rehearing *en banc* is reported at 850 F.2d 1582 and is reproduced at Appendix C hereto. The opinions of the United States District Court for the Southern District of Texas are unreported but are reproduced at Appendix D and Appendix E hereto.

JURISDICTION

The judgment of the court of appeals was entered on May 31, 1988 and is reproduced at Appendix F hereto. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1) (1982).

STATEMENT OF THE CASE

Petitioners opened securities accounts with a financial consultant formerly employed by respondent Shearson Lehman Hutton Inc., named herein as Shearson/American Express, Inc. ("Shearson") in a Shearson branch office located in Brownsville, Texas at various times in 1982 and 1983.[1] At or around the time petitioners opened their accounts, they entered into Customer's Agreements with Shearson. Each of these agreements provides that any controversy relating to the various accounts petitioners maintained with Shearson is to be resolved through arbitration at one of three designated self-regulatory organization ("SRO") arbitration forums:

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I [the customer] may elect.

Petitioners filed complaints against Shearson and their financial consultant in the United States District Court for the Southern District of Texas on August 23, 1985 and November 27, 1985.[2] Petitioners alleged that there had been excessive and unauthorized trading in their accounts, that false statements were made and material facts omitted from the advice given to them, and that certain securities purchased in their accounts were not appropriate in light of their investment objectives. Petitioners alleged that this conduct constituted violations of: (a) §§ 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. § 77a *et seq.* (1982) (the "1933 Act"); (b) § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (1982) (the "1934 Act") and Securities and Exchange Commission ("SEC") Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240-10b-5; (c) §§ 15(c)(1) and 15(c)(2) of the 1934 Act and SEC Rules 15cl-2, 15cl-4 and 15cl-6 promulgated thereunder; (d) §§ 206 and 215 of the Investment Advisors Act of 1940; (e) the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.* (1982) ("RICO"); (f) various state and common laws; and (g) various rules and regulations of the New York Stock Exchange, Inc. ("N.Y.S.E.") and the National Association of Securities Dealers, Inc. ("N.A.S.D.").

Shearson filed a motion in the district court for, among other things, an order to enforce the arbitration agreements entered into by the parties pursuant to § 3 of the United States Arbitration Act, 9 U.S.C. § 1 *et seq.* (1982). In an opinion dated November 18, 1986, the district court granted Shearson's motion to dismiss petitioners' claims asserted under § 17(a) of the 1933 Act and its motion to stay proceedings pending arbitration of all petitioners' remaining claims except those asserted under § 12(2) of the 1933 Act, 15 U.S.C. § 77*l*(2), and those asserted under the 1934 Act. The district court based its refusal to order the parties to arbitrate petitioners' § 12(2) claims on *Wilko* v. *Swan*, 346 U.S. 427 (1953), in which the Court held that an agreement to arbitrate a § 12(2) claim violates § 14 of the 1933 Act, an anti-waiver provision, 15 U.S.C. § 77n, as an agreement waiving the jurisdictional provision of the 1933 Act. *See* Appendix D at A-18 (citing *Wilko*, 346 U.S. at 434-35). The jurisdictional provision of the 1933 Act, § 22(a), provides that a plaintiff may bring an action to enforce rights under the 1933 Act in either a federal or a state court. 15 U.S.C. § 77v(a). The district court's refusal to order arbitration of petitioners' claims asserted under the 1934 Act was based on prior circuit precedent extending the rationale underlying *Wilko* to the 1934 Act. *See* Appendix D at A-19.

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[1] Petitioners are those individuals listed in the Petition for a Writ of Certiorari ("Petition"). *See* Petition at 1 n.1. The parent company of Shearson is Shearson Lehman Hutton Holdings Inc. which is a non-wholly owned subsidiary of the American Express Company. E.F. Hutton & Company, Inc. is a wholly owned subsidiary of Shearson. Petitioners' financial consultant, Jon Grady Deaton, a defendant below, was not a party to the appeal before the Fifth Circuit and is not a party to this proceeding.

[2] The four complaints filed by petitioners in the district court were consolidated for purposes of appeal. The arbitration orders of the district court and court of appeals were identical for all four complaints.

Shearson filed a motion with the district court to reconsider its refusal to order the parties to arbitrate petitioners' claims under § 12(2) of the 1933 Act, based on the rationale underlying this Court's opinion in *Shearson/American Express, Inc. v. McMahon*, 482 U.S. ____, 107 S. Ct. 2332 (1987), wherein the Court ruled that agreements to arbitrate claims under § 10(b) of the 1934 Act and RICO are enforceable. The district court subsequently ruled that petitioners' § 10(b) claims were arbitrable but ruled that their § 12(2) claims were nonarbitrable in an opinion dated July 14, 1987. *See* Appendix E.

Shearson filed an appeal with the United States Court of Appeals for the Fifth Circuit to review the district court's refusal to order the parties to arbitrate petitioners' claims asserted under § 12(2) of the 1933 Act. On May 31, 1988, the Fifth Circuit reversed the district court, ruling that the rationale underlying *McMahon* mandates enforcement of the parties' agreement to arbitrate petitioners' § 12(2) claims. *Rodriguez De Quijas v. Shearson/American Express, Inc.*, 845 F.2d 1296, 1299 (5th Cir.), *reh'g en banc denied*, 850 F.2d 1582 (1988) (per curiam). Petitioners filed a petition for a writ of certiorari to review the order of the Fifth Circuit dated August 31, 1988. Petitioners contend that such a writ should be granted and the Fifth Circuit reversed based on their arguments that:

(a) the Fifth Circuit improperly failed to follow this Court's holding in *Wilko* that § 12(2) claims are nonarbitrable;

(b) the Fifth Circuit's opinion is in conflict with the opinion of the Second Circuit Court of Appeals in *Chang v. Lin*, 824 F.2d 219 (2d Cir. 1987), as well as federal district court and state court opinions; and

(c) Congress has recently proposed a Bill which, if passed, would amend the 1934 Act regarding the enforceability of agreements to arbitrate federal securities law claims.

See Petition at 4-5.

To the extent that petitioners seek a writ of certiorari to resolve the conflict that exists between the Fifth Circuit and Second Circuit Courts of Appeals, as well as various federal district courts and state courts, Shearson agrees that the issuance of a writ of certiorari is needed to provide uniformity throughout the nation on the issue of whether agreements to arbitrate claims asserted under § 12(2) of the 1933 Act are presently enforceable in light of *McMahon*.

REASONS FOR GRANTING THE WRIT

The Fifth Circuit's decision enforcing an agreement to arbitrate claims asserted under § 12(2) of the 1933 Act was based on the rationale underlying this Court's opinion in *McMahon*, wherein the Court held that agreements to arbitrate claims arising under § 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), and RICO are enforceable. The Fifth Circuit chose to rely on *McMahon* as presently governing the issue rather than *Wilko* which held that agreements to arbitrate § 12(2) claims are unenforceable. *Rodriguez*, 845 F.2d at 1298-99. The Tenth Circuit reached the same conclusion in *Peterson v. Shearson/American Express, Inc.*, 849 F.2d 464, 466 (10th Cir. 1988).

The Second Circuit has stated that *Wilko* continues to govern the enforceability of agreements to arbitrate § 12(2) claims until this Court expressly states otherwise. *See Chang v. Lin*, 824 F.2d 219, 222 (2d Cir. 1987). The Third Circuit has chosen to follow the Second Circuit and also continues to rely on *Wilko* rather than *McMahon* on the issue. *See Osterneck v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 841 F.2d 508, 512 (3d Cir. 1988).

The direct conflict among the circuits as to whether *McMahon* or *Wilko* presently governs the enforceability of agreements to arbitrate § 12(2) claims is fully developed. The circuit courts as well as numerous district courts and state courts hold either that the rationale underlying *McMahon* presently governs the issue or that *Wilko* controls until this Court specifically states otherwise. Courts that adhere to *Wilko*, notwithstanding *McMahon*, are fostering the type of judicial hostility against arbitration agreements that this Court and Congress has sought to eliminate. Moreover, the lower courts continue to be burdened with motions to compel arbitration and lawsuits which should be resolved by arbitration. Only this Court can resolve the conflict that exists among the circuits and Shearson respectfully submits that it should do so in the present case.

I. The Fully Developed Conflict Among the Fifth, Tenth, Second and Third Circuits as to Whether *Shearson v. McMahon* Mandates Enforcement of Agreements to Arbitrate Claims Under § 12(2) of the Securities Act of 1933 Can Only Be Resolved by This Court Which Should Grant Certiorari in This Case

The enforceability of agreements to arbitrate claims asserted under § 12(2) of the 1933 Act is an issue which seemed to have been resolved approximately thirty-five years ago in *Wilko v. Swan*, 346 U.S. 427 (1953), wherein the Court ruled that such agreements were unenforceable. The continued viability of *Wilko* has been called into question due to the rationale underlying this Court's opinion in *Shearson/American Express, Inc. v. McMahon*, 482 U.S. ____, 107 S. Ct. 2332 (1987). The Court in *McMahon* ruled that agreements to arbitrate claims asserted under § 10(b) of the 1934 Act (as well as RICO) are enforceable. An application of the rationale underlying the Court's opinion in *McMahon* to § 12(2) of the 1933 Act indicates that claims asserted under this statute are also presently arbitrable.

The Fifth Circuit Court of Appeals in the present case has interpreted *McMahon* to mandate enforcement of valid agreements to arbitrate § 12(2) claims:

> *McMahon* undercuts every aspect of *Wilko v. Swan* . . . .; a formal overruling of *Wilko*, appears inevitable — or, perhaps, superfluous.

Rodriguez, 845 F.2d at 1298 (citing *Noble v. Drexel Burnham Lambert, Inc.*, 823 F.2d 849, 850 n.3 (5th Cir. 1987)).

The Tenth Circuit Court of Appeals has also recognized that an application of the rationale underlying *McMahon* to § 12(2) of the 1933 Act renders agreements to arbitrate these claims presently enforceable notwithstanding *Wilko*:

> In *Wilko*, the Court determined that an agreement to arbitrate was void under § 14 of the 1933 Securities Act .... In *McMahon*, the Supreme Court essentially overruled *Wilko*. *See Rodriguez De Quijas v. Shearson/American Express, Inc.*, 845 F.2d 1296 (5th Cir. 1988). In doing so, the Court recognized arbitration as an acceptable method of dispute resolution under the 1934 Exchange Act.

Peterson v. Shearson/American Express, Inc., 849 F.2d 464, 466 (10th Cir. 1988).

In contrast, the Second Circuit Court of Appeals in *Chang v. Lin*, 824 F.2d 219 (2d Cir. 1987) has stated that *Wilko* continues to govern the issue of the enforceability of agreements to arbitrate § 12(2) claims until this Court states otherwise:

> Although the Supreme Court in *McMahon* questioned the rationale underlying *Wilko*, the Court nevertheless did not overrule that decision, and it continues to govern us.

Chang, 824 F.2d at 222. The Third Circuit has reached the same conclusion as did the Second Circuit in *Chang*. In *Osterneck v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 841 F.2d 508 (3d Cir. 1988), the Third Circuit stated:

> As long as *Wilko* stands in the Supreme Court, agreements to arbitrate claims under the Securities Act of 1933 will remain unenforceable....

Osterneck, 841 F.2d at 512.

The conflict among the Fifth, Tenth, Second and Third Circuit Courts of Appeals as to whether *McMahon* or *Wilko* presently governs the issue of the enforceability of agreements to arbitrate § 12(2) claims is mirrored by a similar conflict that exists among the federal district courts and the state courts

nationwide.[3] These courts have recognized the clear conflict that exists on the issue and have chosen to follow either the Fifth and Tenth Circuits' approach or the Second and Third Circuits' approach. For example, the United States District Court for the Eastern District of Pennsylvania recently ruled that agreements to arbitrate § 12(2) claims are unenforceable, relying on *Osterneck* and *Chang* rather than *Rodriguez*:

> The Court of Appeals for the Third Circuit explicitly held in *Osterneck* — that until *Wilko* is expressly overturned, "agreements to arbitrate claims under the Securities Act of 1933 will remain unenforceable." Therefore, I find that the Supreme Court has not expressly overruled its decision in *Wilko*. *See Chang* ... *But See Rodriguez* ....

Abadian v. Drexel Burnham Lambert, Inc., No. 88-0186 (E.D. Pa. Aug. 5, 1988) (LEXIS, Fedsec library, Courts file) (citations omitted). *See also Jeppsen v. Piper, Jaffray & Hopwood, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 93, 996 at p. 90,651 (D. Utah Aug. 16, 1988) ("The Tenth Circuit has taken the position that '[i]n *McMahon*, the Supreme Court essentially overruled *Wilko*.' ").

Although Shearson contends that the Fifth Circuit properly ruled that the rationale underlying the Court's opinion in *McMahon* mandates enforcement of agreements to arbitrate § 12(2) claims, it believes that it is essential for the Court to grant certiorari to review and affirm the Fifth Circuit's opinion and resolve the conflict that exists on this issue. Without the Court's definitive resolution of the issue, parties to valid arbitration agreements will be denied the right to have § 12(2) disputes

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[3] Shearson is aware of twenty-nine cases nationwide that have decided the enforceability of agreements to arbitrate claims asserted under § 12(2) and other sections of the 1933 Act since this Court decided *McMahon*. Sixteen decisions have held that such agreements are enforceable based on *McMahon*, while thirteen decisions have held that such agreements are unenforceable based on *Wilko*. A complete list of the district and state court decisions on this issue appears at Appendix G.

resolved in an arbitration forum capable of enforcing rights under the federal securities laws pursuant to the United States Arbitration Act. As a result, courts will continue to be burdened with unnecessary motions to compel arbitration and lawsuits asserting claims that should be resolved through arbitration. The Court should end this waste of judicial resources. This is especially so due to the fact that the SEC, the governmental agency responsible for administering the federal securities laws, has already advised the Court in the *amicus curiae* brief it filed in *McMahon* in support of Shearson, that it believes that agreements to arbitrate § 12(2) claims are presently enforceable:

> [A] present-day customer-broker agreement to arbitrate pursuant to SRO arbitration procedures would be enforceable, even with respect to claims arising under Section 12(2) of the 1933 Act, the section under which the claim in *Wilko* arose. . . .

See Brief of the SEC as *Amicus Curiae* in McMahon ("SEC *amicus* brief") at 20.[4]

Shearson respectfully suggests that the Court end the unnecessary waste of judicial resources that are being expended by courts which continue to force parties to litigate § 12(2) claims in a judicial forum notwithstanding the existence of valid contractual arbitration agreements covering these claims. The Court should grant certiorari to review and affirm the Fifth Circuit's opinion in this case and protect the Congressional policies underlying the Arbitration Act.[5]

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[4] The arbitration agreements governing the parties' disputes in the present case provide that the arbitration forum to hear their disputes will be one of three designated SRO forums just as the arbitration agreement governing the parties' disputes in *McMahon* provided.

[5] A petition for a writ of certiorari was filed with the Court in *Dain Bosworth Inc. v. Johnson*, No. C9-87-1784, *petition for cert. filed*, 57 U.S.L.W. 3161 (U.S. Aug. 12, 1988) (No. 88-284), seeking review of the same issue presented in this case. The petitioner in *Johnson* is seeking a writ of certiorari for the Court to review an order of the Minnesota Supreme Court which denied review of a decision of the Minnesota Court of Appeals affirming a refusal to order arbitration of a claim asserted under § 12(2) of the 1933 Act.

A. The Fifth and Tenth Circuits Have Held That *Shearson v. McMahon* Presently Renders Agreements to Arbitrate § 12(2) Claims Enforceable

The Fifth Circuit in the present case expressly chose to follow the rationale underlying this Court's opinion in *McMahon* to support its ruling that agreements to arbitrate claims asserted under § 12(2) of the 1933 Act are enforceable notwithstanding the contrary holding in *Wilko*. *Rodriguez*, 845 F.2d at 1298-99. The Tenth Circuit in *Peterson* also stated that *McMahon* presently governs the enforceability of agreements to arbitrate § 12(2) claims. *Peterson*, 849 F.2d at 466. The Court in *McMahon* was faced with, among other things, the issue of whether an agreement to arbitrate a claim arising under § 10(b) of the 1934 Act is enforceable. The Court had to reconcile the *Wilko* opinion and determine if *Wilko* applied to § 10(b) of the 1934 Act.

The *Wilko* Court had held that an agreement to arbitrate a claim under § 12(2) of the 1933 Act was unenforceable as an agreement waiving the jurisdictional provision of the 1933 Act which provides for concurrent jurisdiction in both the federal district courts and state courts to resolve disputes under the 1933 Act. *See Wilko*, 346 U.S. at 434-35. The Court based its decision on its interpretation of the anti-waiver provision of the 1933 Act which precludes enforcement of any agreement which waives "compliance with any provision" of the 1933 Act. § 14, 15 U.S.C. § 77n. Since the *Wilko* Court believed that an arbitration forum was not capable of enforcing rights under the 1933 Act, the Court concluded that an agreement waiving the right to have a judicial forum resolve a § 12(2) claim was prohibited as an agreement "waiving compliance" with the 1933 Act:

> As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress must have intended § 14 . . . to apply to waiver of judicial trial and review [of § 12(2) claims].

Wilko, 346 U.S. at 437 (citation and footnote omitted).

Due to the fact that the 1934 Act contains an anti-waiver provision, § 29(a), 15 U.S.C. § 78cc(a), which is in all substantive respects the same as the anti-waiver provision contained in the 1933 Act, the courts of appeals had assumed that *Wilko* applied equally to the 1934 Act rendering agreements to arbitrate claims under § 10(b) of the 1934 Act unenforceable.[6] The Court in *McMahon* rejected the application of *Wilko* to § 10(b) of the 1934 Act. The Court recognized that the *Wilko* Court's interpretation of an anti-waiver provision as prohibiting an agreement to arbitrate a § 12(2) claim was based solely on its view that arbitration was inadequate to protect rights under the statute:

> The conclusion in *Wilko* was expressly based on the Court's belief that a judicial forum was needed to protect the substantive rights created by the Securities Act: "As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress must have intended § 14 . . . to apply to waiver of judicial trial and review." *Wilko* must be understood, therefore, as holding that the plaintiff's waiver of the "right to select the judicial forum," . . . was unenforceable only because arbitration was judged inadequate to enforce the statutory rights created by § 12(2).

McMahon, 107 S. Ct. at 2338.

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[6] *See Surman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 733 F.2d 59, 61-62 (8th Cir. 1984); *Belke v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 693 F.2d 1023, 1025-26 (11th Cir. 1982); *Delancie v. Birr, Wilson & Co.*, 648 F.2d 1255, 1258-59 (9th Cir. 1981); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1030 (6th Cir. 1979); *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Moore*, 590 F.2d 823, 827-29 (10th Cir. 1978); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 558 F.2d 831, 833-35 (7th Cir. 1977); *Allegaert v. Perot*, 548 F.2d 432, 436-38 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977); *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 536 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976); *Sibley v. Tandy Corp.*, 543 F.2d 540 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977).

After analyzing the arbitration forums maintained by the various SROs, the Court ruled that these forums are adequate to protect and enforce rights under the federal securities laws even if they were not when *Wilko* was decided:

> [T]he mistrust of arbitration that formed the basis for the *Wilko* opinion in 1953 is difficult to square with the assessment of arbitration that has prevailed since that time. This is especially so in light of intervening changes in the regulatory structure of the securities laws.

McMahon, 107 S. Ct. at 2341. The Court relied on the fact that, unlike during the time when *Wilko* was decided, the SEC presently has broad power to ensure the adequacy of SRO arbitration. This power was granted to the SEC by Congress in its 1975 amendments to § 19 of the 1934 Act, 15 U.S.C. § 78s. Examples of the SEC's broad oversight power are its power to "abrogate, add to, and delete from" any SRO rule if it is inconsistent with the federal securities laws and the fact that no proposed rule change may take effect unless first approved by the SEC. *See* § 19(b)(2), 15 U.S.C. § 78s(b)(2); § 19(c), 15 U.S.C. 78s(c). Moreover, the SEC has specifically approved of the arbitration procedures of the N.Y.S.E., the N.A.S.D. and the American Stock Exchange, Inc., the SRO arbitration forums that were listed in the arbitration agreement that governed the parties' disputes in *McMahon* and which govern the parties' disputes in the present case.[7] It was for these reasons that the Court in *McMahon* found that an arbitration forum is capable of enforcing rights under the 1934 Act rendering the *Wilko* interpretation of an anti-waiver provision inapplicable to § 10(b) of the 1934 Act. *McMahon*, 107 S. Ct. at 2341-42.

The Court's refusal to rely on the *Wilko* Court's interpretation of an anti-waiver provision as prohibiting an agreement to arbitrate claims under the federal securities laws, was not based on any distinction between the 1933 Act and the 1934 Act, and was due solely to the significant changes in securities arbitration that have been made since *Wilko* was decided:

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[7] *See* SEC Securities Exchange Act Release No. 16390 (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979); *see also* SEC *amicus* brief at 18.

> Even if *Wilko*'s assumptions regarding arbitration were valid at the time *Wilko* was decided, most certainly they do not hold true today for arbitration procedures subject to the SEC's oversight authority.

McMahon, 107 S. Ct. at 2341.

The rationale underlying *McMahon* applies equally to both the 1933 Act and the 1934 Act rendering the *Wilko* interpretation of an anti-waiver provision presently incapable of prohibiting an agreement to arbitrate a § 12(2) claim at an SRO arbitral forum. The Fifth and Tenth Circuit Courts of Appeals' recognition of this fact led these courts to state that agreements to arbitrate § 12(2) claims are presently enforceable. Thus, courts within the Fifth and Tenth Circuits will no longer refuse to enforce parties' agreements to resolve their § 12(2) disputes at forums which this Court has ruled are perfectly capable of protecting rights under the federal securities laws.[6]

Unlike the Fifth and Tenth Circuit Courts of Appeals, the Second and Third Circuit Courts of Appeals have refused to acknowledge the fact that *Wilko* no longer renders agreements to arbitrate § 12(2) claims unenforceable in light of the rationale underlying *McMahon*.

B. The Second and Third Circuits Have Held That *Wilko* v. *Swan* Continues To Prohibit Pre-Dispute Agreements To Arbitrate § 12(2) Claims Notwithstanding *Shearson* v. *McMahon* Until This Court States Otherwise

The Second Circuit has made it clear in *Chang* that it will adhere to *Wilko* and refuse to enforce valid agreements to arbitrate § 12(2) claims until this Court specifically states that such agreements are presently enforceable. *Chang*, 824 F.2d at 222. Although the issue of the enforceability of agreements to arbitrate § 12(2) claims was not squarely before the Second

[6] *See, e.g., Reed* v. *Bear, Stearns & Co.*, No. 88-2040-0 (D. Kan. Aug. 19, 1988) (LEXIS, Fedsec library, Courts file) (§ 12(2) claims arbitrable based on the *Rodriguez* and *Peterson* interpretation of *McMahon*); *see also Jeppson*.

Circuit in *Chang*, the court's statement that "a plaintiff has the right to litigate a '33 Act claim in a federal court notwithstanding any arbitration agreement with the defendant," *Id.*, has caused and will continue to cause courts within the Second Circuit to refuse to enforce valid agreements to arbitrate § 12(2) claims. *See, e.g., McCowan v. Dean Witter Reynolds, Inc.*, 682 F. Supp. 741, 744 (S.D.N.Y. 1987) (*Wilko* still governs arbitrability of § 12(2) claims citing *Chang*). The same is true for courts within the Third Circuit due to *Osterneck*. *See, e.g., Abadian*.

The fact that the § 12(2) issue was not specifically decided by the Court in *McMahon*, since the issue was not before it, is the reason numerous federal district courts and state courts in addition to the Second and Third Circuits continue to fail to recognize that valid agreements to arbitrate claims under § 12(2) of the 1933 Act are presently enforceable in light of the Court's rationale underlying *McMahon*. *See* Appendix G. It is thus essential that the Court resolve the conflict that exists among the lower federal courts and specifically rule on the present enforceability of agreements to arbitrate § 12(2) claims. There are no further arguments to be developed by the lower federal courts. These courts either decide to accept the *McMahon* rationale to enforce agreements to arbitrate § 12(2) claims or decide to remain bound by *Wilko* until told otherwise by the Court. Until the Court resolves the issue definitively, its recent precedents which have developed significant substantive law under the Arbitration Act and the Congressional policies underlying the Act will continue to be thwarted.

II. The Refusal of Courts to Enforce Agreements to Arbitrate § 12(2) Claims Continues to Infringe Upon Congressional Policies Underlying the Arbitration Act and Recent Precedent of This Court

Congress enacted the Arbitration Act to reverse judicial hostility against arbitration agreements which had existed in the English common law and was adopted by the American Courts. H.R. Rep. No. 96, 68th Cong., 1st Sess. 1-2 (1924). Congress' intent underlying the enactment of the Act was to ensure that courts would defer to arbitration agreements as they would to any contractual agreement:

> Arbitration agreements are purely matters of contract, and the effect of the bill is simply to make the contracting party live up to his agreement. He can no longer refuse to perform his contract when it becomes disadvantageous to him. An arbitration agreement is placed upon the same footing as other contracts, where it belongs.

Id. The Arbitration Act provides that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The Act mandates that a court stay its proceedings and direct the parties to an arbitration agreement to resolve their disputes in an arbitration forum. 9 U.S.C. § 3-4.

The Court has decided several cases involving arbitration issues in recent years to protect Congress' desire to ensure the enforcement of valid arbitration agreements and has created significant substantive law in furtherance of the Arbitration Act. In ruling that agreements to arbitrate § 10(b) and RICO claims are enforceable in *McMahon*, the Court reiterated the strength of the Arbitration Act:

> The Arbitration Act thus establishes a "federal policy favoring arbitration," *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983), 103 S. Ct. 927, 941, 74 L. Ed.2d 765 (1983), requiring that "we rigorously enforce agreements to arbitrate." *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985).

McMahon, 107 S. Ct. at 2337.

The Court in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), rejected the argument that public policy concerns require that claims under the antitrust laws be resolved solely in a judicial and not an arbitral forum. The Court held that antitrust claims can be resolved by arbitration even though "[t]he treble-damages provision wielded by the private litigant is a chief tool in the antitrust enforcement scheme, posing a crucial deterrent to potential violators." *Mitsubishi*, 473 U.S. at 614. More importantly, the Court conclusively established that claims founded upon statutes can be arbitrated:

> The [Arbitration Act] provides no basis for disfavoring agreements to arbitrate statutory claims by skewing the otherwise hospitable inquiry into arbitrability.

Id. The Court in *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985), after scrutinizing the legislative history of the Arbitration Act, held that its primary purpose was to ensure judicial enforcement of privately made agreements to arbitrate, rather than to promote the speedy and expeditious resolution of disputes. *Byrd*, 470 U.S. at 219.

All of these precedents taken together with *McMahon* should indicate to the lower federal courts that valid agreements to arbitrate § 12(2) claims should be enforced pursuant to the Arbitration Act. The continued refusal by many courts to enforce valid agreements to arbitrate § 12(2) claims conflicts with the rationale underlying *McMahon*, as well as Congressional intent underlying the Aribtration Act and continues to foster the type of judicial hostility against arbitration agreements that this Court and Congress has sought to eliminate:

> [W]e are well past the time when judicial suspicion of the desirability of arbitration and the competence of arbitral tribunals should inhibit enforcement of the Act . . . .

McMahon, 107 S. Ct. at 2337 (citing *Mitsubishi*, 473 U.S. at 627). The Court should grant certiorari to review and affirm the Fifth Circuit's opinion and thereby ensure that the substantive law it has created under the Arbitration Act in furtherance of Congressional intent is no longer thwarted by courts relying on outdated precedent.

III. The Conflict and Confusion Among the Lower Courts Requires Early Resolution to Avoid Increased Congestion in the Lower Courts

As long as the enforceability of agreements to arbitrate § 12(2) claims is not definitively resolved, the issue will continue to be the subject of motion and appellate practice consuming inordinate and unnecessary amounts of judicial resources. Each week brings new filings of securities-related cases in addition to those currently pending in the courts. Statistics compiled by the Administrative Office of the United States Courts reveal that during the twelve months ended June 30, 1987, a total of 2,844 "Securities, Commodities, and Exchanges" private civil actions were filed in the federal district courts. *See* Annual Report of the Director of the Administrative Office of the United States Courts, Table C2 (1987). This flood of private securities lawsuits, many raising claims subject to valid arbitration agreements will continue to force the district courts to decide the enforceability of such agreements and, perhaps, to decide claims that parties had agreed to resolve by arbitration. The burden on the district courts of leaving the issue of the enforceability of agreements to arbitrate § 12(2) claims unresolved is not limited to deciding numerous motions to compel arbitration. When the courts within the Second and Third Circuits are added to the substantial number of courts that may choose to follow their

opinions in *Chang* and *Osterneck* as well as all of the federal district and state courts that have already refused to enforce agreements to arbitrate § 12(2) claims, *see* Appendix G, it is clear that, unless this Court acts to resolve the issue quickly, a significant number of otherwise arbitrable disputes will be litigated in already overcrowded courts.

The Arbitration Act reflects a strong Congressional policy in favor of reducing congestion in courts. When parties agree that a claim should be resolved out of court and in a forum that this Court has already ruled to be fair, impartial and adequate to resolve statutory disputes, only explicit Congressional intent should prohibit that agreement and require the expenditure of the time and resources required by litigation in a judicial forum.

An express declaration by the Court that the rationale underlying its opinion in *McMahon* mandates enforcement of agreements to arbitrate § 12(2) claims will also eliminate another source of waste — the maintenance of duplicative proceedings in separate forums. As a result of this Court's decisions in *Byrd* and *McMahon*, courts are required to compel arbitration of claims asserted under § 10(b) of the 1934 Act, RICO and state and common law. Those courts that refuse to compel a § 12(2) claim asserted in the same lawsuit to arbitration require, and will continue to require the parties to litigate the § 12(2) claim in court while at the same time arbitrate the other claims. Considering that all of these claims are based on the same underlying factual allegations, these types of parallel and duplicative proceedings are extremely wasteful.

Shearson respectfully submits that the Court should grant certiorari and resolve the conflict among the lower federal courts by affirming the Fifth Circuit's decision rendering agreements to arbitrate § 12(2) claims enforceable.

CONCLUSION

For all of the foregoing reasons, respondent Shearson respectfully suggests that the Court issue a writ of certiorari in this case to review and affirm the decision of the United States Court of Appeals for the Fifth Circuit.

DATED: New York, New York
October 20, 1988

Respectfully submitted,

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APPENDIX

APPENDIX A

STATUTORY AND REGULATORY PROVISIONS INVOLVED

United States Arbitration Act

9 U.S.C. § 2:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 3:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

Securities Act of 1933

Section 12(2), 15 U.S.C. § *77l(2)*:

> Any person who –
>
> . . .

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 14, 15 U.S.C. § 77n:

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

Section 22(a), 15 U.S.C. § 77v(a):

The district courts of the United States and United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and

actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of Title 28. No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against it in the Supreme Court or such other courts.

Securities Exchange Act of 1934

Section 10, 15 U.S.C. § 78j(b):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

• • •

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 27, 15 U.S.C. § 78aa:

> The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts.

Section 29(a), 15 U.S.C. § 78 cc(a):

> Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule or an exchange required thereby shall be void.

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Nos. 87-2888, 87-2889,
87-2890, 87-2891

OPELIA RODRIGUEZ DE QUIJAS, ET AL.,

Plaintiffs-Appellees,

—versus—

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a SHEARSON/AMERICAN EXPRESS, INC.,
and JON GRADY DEATON,

Defendants-Appellants.

• • • • • • • • • • •

MARY GRACE NORMAN,

Plaintiff-Appellee,

—versus—

SHEARSON/LEHMAN BROTHERS, INC., f/k/a
SHEARSON/AMERICAN EXPRESS, INC., ETC., ET AL.,

Defendants-Appellants.

• • • • • • • • • • •

ADELINA TRAPERO,

Plaintiff-Appellee,

—versus—

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a SHEARSON/AMERICAN EXPRESS, INC.,
It's Successors and Assigns, and
JON GRADY DEATON, Jointly and Severally,

Defendants-Appellants.

• • • • • • • • • • •

GENE GRIFFIN and GERTRUD GRIFFIN,
Plaintiffs-Appellees,

—versus—

SHEARSON/LEHMAN BROTHERS, INC., f/k/a SHEARSON/AMERICAN EXPRESS, INC., ETC., ET AL.,
Defendants-Appellants.

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS

Before THORNBERRY, WILLIAMS and DAVIS, Circuit Judges.

JERRE S. WILLIAMS, Circuit Judge:

In these consolidated cases we confront the issue of whether claims brought under § 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(2) (1982), are subject to predispute arbitration agreements. This issue arises in the wake of *Shearson/American Express, Inc. v. McMahon*, ___ U.S. ___, 107 S.Ct. 2332, ___ L.Ed.2d ___ (1987), which enforced a predispute agreement to arbitrate § 10(b) claims under the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982). We find § 12(2) claims to be arbitrable, notwithstanding the earlier precedent of *Wilco v. Swan*, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1958).

I.

Appellees are individual investors in Brownsville, Texas, who suffered financial losses as the alleged result of unauthorized, fraudulent transactions in securities. Approximately $190,000 was invested by the Rodriguez De Quijas family; $38,000 by Mary Grace Norman; $100,000 by Adelina Trapero; and $80,000 by Gene and Gertrud Griffin. They sued appellants Jon Grady Deaton, the agent in charge of the accounts, and Shearson/American Express, Inc. ("Shearson"), pleading violations of various state and federal laws.[1] Appellant Shearson moved to compel arbitration pursuant to an arbitration clause contained in the customer agreements signed by each appellee,[2] and in accordance with the Federal Arbitration Act.[3]

[1] Their common claims include violations of §§ 12(2) and 17(a) of the 1933 Securities Act, and §§ 10(b), 15(c)(1), 15(c)(2) of the Securities Exchange Act of 1934; civil RICO violations consisting of mail and wire fraud under 18 U.S.C. §§ 1341, 1343, and 1961 (1982); securities fraud in violation of TEX. REV. CIV. STAT. ANN. § 581-33(A)(2) (Vernon 1964); violations of the Texas Deceptive Trade Practices Act, TEX. BUS. and COMM. CODE ANN. § 1746 *et seq.* (Vernon 1986); and common law breach of contract, fraud, and misrepresentation. The district court properly dismissed appellees' Securities Act § 17(a) claims under Fed.R.Civ.P. 12(b)(6), because this Court has held that there is no such private cause of action. *Landry v. All American Assurance Co.*, 688 F.2d 381 (5th Cir. 1982).

[2] Paragraph 13 of the Customer's Agreement provides:

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, the transactions with you for me, or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules then in effect of the National Association of Securities Dealers, Inc., or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I may elect. If I do not make such election by registered mail addressed to you at your main office within five (5) days after demand by you that I make such election then you may make such election. Judgment upon any award ordered by the arbitrators may be entered in any court having jurisdiction thereof.

[3] The Federal Arbitration Act, 9 U.S.C. § 1 *et. seq.* (1982) ("FAA"), mandates enforcement of agreements to arbitrate. *E.g., Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983). The FAA states in pertinent part:

> § 2. Validity, irrevocability, and enforcement of agreements to arbitrate
>
> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration on a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part, thereof, or an agreement in writing to submit to arbitration an

(footnote continued)

The district court ordered arbitration of all claims except for the federal securities claims.

The district court correctly followed the Supreme Court's decision in *Wilco v. Swan*, *supra*, which clearly set out the invalidity of agreements to arbitrate § 12(2) claims under the Securities Act. And until recently, *Wilco* was interpreted in this Circuit as barring arbitration of Securities Exchange Act claims as well. *E.g. Mayaja, Inc. v. Bodkin*, 803 F.2d 157 (5th Cir. 1986), *cert. denied in part* ____ U.S. ____, 1075 S.Ct. 3210, 96 L.Ed.2d ____, *vacated in part*, ____ U.S. ____, 107 S.Ct. 3205, 96 L.Ed.2d 692 (1987); *Bustamonte v. Rotan Mosle, Inc.*, 802 F.2d 815 (5th Cir. 1986); *King v. Drexel Burnham Lambert, Inc.*, 796 F.2d 59 (5th Cir. 1986) vacated, ____ U.S. ____, 107 S.Ct. 3203, 96 L.Ed.2d 690 (1987). But the Supreme Court with *Shearson/American Express, Inc. v. McMahon*, *supra*, established the arbitrability of Securities Exchange Act claims. Appellant Shearson asserts this decision effectively overrules *Wilco* and allows arbitration of Securities Act claims.

Appellees do not contest the arbitrability of their Exchange Act claims following *McMahon*. They argue only that *Wilco* remains good law and prohibits arbitration of claims brought under § 12(2) of the Securities Act. Appellees argue further that even if § 12(2) claims are arbitrable, the parties lacked the requisite intent to agree to arbitration. We address these claims.

II.

The Supreme Court in *McMahon*, enforced a predispute agreement to arbitrate claims brought under § 10(b) of the 1934 Exchange Act. *Supra* at ____, 107 S.Ct. at 2343. In doing so, it refused under the 1934 Act to follow the reasoning of *Wilco v. Swan*, which invalidated predispute agreements to arbitrate 1933 Act

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(footnote continued)

> *existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.*

claims. *McMahon*, *supra*, at 538, 74 S.Ct. at 188-89. The *McMahon* majority opinion does not expressly overrule *Wilco*; the precise issue of the arbitrability of § 12(2) claims was not before the court.[4] Nevertheless, the reasoning in *McMahon* completely undermined *Wilco*, as this Court noted in *Noble v. Drexel Burnham Lambert, Inc.*, 823 F.2d 849, 850 n.3. (5th Cir. 1987)("*McMahon* undercuts every aspect of *Wilco v. Swan* . . . ; a formal overruling of *Wilco*, appears inevitable – or, perhaps, superfluous.").

The basic premise of *Wilco* is that a predispute agreement to arbitrate § 12(2) claims is invalid by virtue of § 14 of the Securities Act, 15 U.S.C. § 77n. (1982). Secton 14 voids any stipulation "to waive compliance with any provision" of the Securities Act. The *Wilco* court held the jurisdictional provision of the Securities Act to be the type of non-waivable provision contemplated in § 14. *Wilco*, *supra*, 346 U.S. at 434, 74 S.Ct. at 186. The Supreme Court states in *McMahon*, however, that § 29(a) of the Exchange Act, 15 U.S.C. § 78cc(a)(1982), which is a non-waiver provision virtually identical to § 14 of the Securities Act, does not bar predispute arbitration agreements. *McMahon*, *supra*, ____ U.S. at ____, 107 S.Ct. at 2338-39.[5]

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[4] The opinion states: "While stare decisis concerns may counsel against upsetting *Wilco*'s contrary conclusion under the Security Act, we refuse to extend *Wilco*'s reasoning to the Exchange Act. . . ." *McMahon*, *supra* ____ U.S. at __, 107 S.Ct. at 2341.

[5] The *McMahon* court reasons that § 29(a) voids only those agreements which waive "compliance" with provisions of the Exchange Act, and that because the jurisdictional provision of the Exchange Act does not impose substantive obligations with which to comply, nothing prevents its waiver. *Supra*, at ____, 107 S.Ct. at 2338. Section 27, the jurisdictional provision of the Exchange Act, 15 U.S.C. § 78aa (1982), is similar to the jurisdictional provision of the Securities Act. Section 27 of the Exchange Act states in part:

> The district courts of the United States . . . shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enfore any liability or duty created by this title or the rules and regulations thereunder.

(footnote continued)

The Supreme Court reconciles *McMahon* with *Wilco* by characterizing the 1953 opinion as outdated in its bias against arbitration. The *McMahon* majority opinion reinterprets *Wilco*, as follows: "*Wilco* must be read as barring waiver of a judicial forum only where arbitration is inadequate to protect the substantive rights at issue." *McMahon*, *supra*, at ____, 107 S.Ct. at 2339. As *McMahon* makes clear, the Supreme Court no longer considers arbitration inadequate to protect substantive rights. *Id.*, at ____, 107 S.Ct. at 2340-41. For this proposition, the court relied upon *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614, 105 S.Ct. 3346, 87 L.Ed.2d 444 (1985); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 105 S.Ct. 1238, 84 L.Ed.2d 158 (1985); *Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852, 79 L.Ed.2d 1 (1984); *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983); and *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 94 S.Ct. 2449, 41 L.Ed.2d 270 (1974). Advances in arbitration noted by the Supreme Court, particularly the broad oversight authority of the Securities Exchange Commission, *McMahon*, *supra*, at ____, 107 S.Ct. at 2341, apply equally to the protection of substantive rights under both the Securities Act and the Exchange Act.

Appellees argue, however, that congressional intent is the crucial distinction between the two Acts. They claim that Congress, by preserving *Wilco* in the 1975 revisions of the Exchange Act, manifested its intent that at least § 12(2) claims should

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(footnote continued)
Compare § 22(a), the jurisdictional provision of the Securities Act, 15 § 77(a)(1982), which reads as follows:

> The district courts of the United States . . . shall have jurisdiction . . . concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found.

remain non-arbitrable.[6] We find it implausible that Congress intended to prohibit arbitration of Securities Act claims but intended to allow courts to determine the arbitrability of Exchange Act claims.[7] Similarly fine distinctions between the two Acts have been presented throughout the course of the debate over securities arbitration. *See, e.g.*, *McMahon*, *supra*, at ____, 107 S.Ct. at 2347 n.n.1-2 (Blackmun J., dissenting). We do not, however, find these asserted distinctions controlling on the issue of arbitration. The Supreme Court opinion in *McMahon*, which binds us here, turns solely on the adequacy of arbitration to resolve securities disputes. It does not distinguish between the Exchange Act and the Securities Act. Furthermore, it has been the position of this Court that, for the purposes of arbitration, similarities between the Securities Act and the Exchange Act outweigh any differences between them. *Sibley v. Tandy Corp.*, 543 F.2d 540, 543 n.3 (1976). We thus follow the reasoning of the Supreme Court in *McMahon* and our own decision in *Noble* which lead directly to the obsolescence of *Wilco* and the arbitrability of Securities Act § 12(2) claims.

III.

Appellees claim that even if § 12(2) claims are arbitrable, the intent to agree to arbitration was lacking in their cases. At the time the agreements were signed, claim appellees, Securities Act claims were controlled by *Wilco* and clearly were not subject to

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[6] The Conference Report accompanying the amendments to § 28(b) of the Exchange Act, 15 U.S.C. § 78bb(b), reads as follows:

> It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilco v. Swan*, 346 U.S. 427 (1953), concerning the effect of arbitration proceedings provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations.

H. R. Conf. Rep. No. 229, 94th Cong., 1st Sess., 111 (1975).

[7] The Supreme Court states in *McMahon*, *supra*, at ____, 107 S.Ct. at 2343: "Hence, the *Wilco* issue was left to the courts: it was unaffected by the amendment to § 28(b)."

arbitration. We cannot conclude that appellees lacked the intent to agree to arbitration because, at the time the customer agreements were signed, courts refused to honor clauses compelling arbitration of securities claims. At the time the contracts were signed, the same circumstances existed barring arbitration of Exchange Act claims. *E.g. Sibley, supra*, at 543. Appellees cannot now contend that they lacked the intent to arbitrate their Exchange Act claims in view of the Court's holding in *McMahon*. Neither the Supreme Court nor this Circuit considered that the earlier lack of authorization to arbitrate was an obstacle in *McMahon, supra* or *Noble, supra*. Both cases ordered arbitration of Exchange Act claims under analogous circumstances.

Authority no longer exists to deny arbitration of the § 12(2) claims as the parties agreed in their contracts. Arbitration must be directed both as to the Securities Act claims and Exchange Act claims. That portion of the judgment of the district court which denied directing arbitration of the Securities Act § 12(2) claims is

REVERSED.

Clerk, U.S. Court of Appeals, Fifth Circuit

By /s/ Sarah L. Holmes

Deputy

New Orleans, Louisiana

OCT 7 1988

APPENDIX C

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Nos. 87-2888, 87-2889,
87-2890 & 87-2891

OPELIA RODRIGUEZ DE QUIJAS, et al.,

Plaintiffs-Appellees,

v.

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a SHEARSON/AMERICAN EXPRESS, INC.,
and JON GRADY DEATON,

Defendants-Appellants.

* * * * * * * * * * *

MARY GRACE NORMAN,

Plaintiff-Appellee,

v.

SHEARSON/LEHMAN BROTHERS, INC., f/k/a
SHEARSON/AMERICAN EXPRESS, INC., etc., et al.,

Defendants-Appellants.

* * * * * * * * * * *

ADELINA TRAPERO,

Plaintiff-Appellee,

v.

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a SHEARSON/AMERICAN EXPRESS, INC.,
Its Successors and Assigns, and
JON GRADY DEATON, Jointly and Severally,

Defendants-Appellants.

* * * * * * * * * * *

GENE GRIFFIN and GERTRUD GRIFFIN,
Plaintiffs-Appellees,

v.

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a SHEARSON/AMERICAN EXPRESS, INC., etc., et al.,
Defendants-Appellants.

APPEALS FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS

ON PETITION FOR REHEARING

(June 22, 1988)

Before THORNBERRY, WILLIAMS and DAVIS,
Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby denied.

ENTERED FOR THE COURT:

/s/ _____
United States Circuit Judge

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
BROWNSVILLE DIVISION

OFELIA RODRIGUEZ DE QUIJAS,	§	
ET AL.	§	
	§	
VS.	§	C. A. NO.
	§	B-85-360
SHEARSON/AMERICAN EXPRESS, INC.	§	
Its Successors and Assigns, and	§	
JON GRADY DEATON, Jointly and	§	
Severally	§	

MEMORANDUM AND ORDER

FACTS

In August of 1985, Plaintiffs Ofelia Rodriguez de Quijas, *et al.* brought suit against Defendants Shearson/American Express and Jon Grady Deaton based upon a series of transactions involving the financial management of separate accounts totalling approximately $190,000. Plaintiffs allege that Defendant Deaton, the manager of the discretionary account with Shearson, fraudulently induced the Plaintiffs to enter into the investment contract. Additionally, it is alleged that Defendants conducted a number of unauthorized and/or fraudulent transactions and misrepresented to Plaintiffs the nature of these transactions. These transactions, it is asserted, were designed to generate commissions and profits for Defendants and resulted in staggering losses for the Plaintiffs. Plaintiffs bring this action under sections 12(2) and 17(a) of the 1933 Federal Securities Act and sections 10(b) (and rule 106-5 thereunder), 15(c)(1), 15(c)(2) of the Securities Exchange Act of 1934 (and rules 15cl-2, 15cl-4, 15cl-6, thereunder). Plaintiffs also assert civil RICO claims based upon predicate acts of mail and wire fraud, in violation of 18 U.S.C. § 1341, § 1343, and § 1961, as well as acts of securities fraud in violation of TEX. CIV. ART. 581-33(A)(2), claims under the Texas Deceptive Trade Practices Act, TEX. BUS.

& COM. CODE ANN. § 17.46 *et seq.* (Vernon 1986), and common law breach of contract, fraud, and misrepresentation.

Defendants have filed a Motion to Compel Arbitration of all the claims arising out of transactions in question pursuant to an arbitration clause in the investment contracts signed by the Plaintiffs. The Court must now decide which of the claims must be arbitrated.

A) *The Arbitration Clause*

The question whether arbitration is controlling is determined on the basis of the existence of an arbitration clause that on its face appears broad enough to encompass the parties' claims. *Mar-Len of LA., Inc. v. Parsons-Gilbane*, 773 F.2d 633, 635 (5th Cir. 1985); *Commerce Park at DFW Freeport v. Mardian Construction Co.*, 729 F.2d 334, 338 (5th Cir. 1984). The Fifth Circuit in *Commerce Park* reasoned that when confronted with an arbitration clause, a presumption arises that arbitration should not be denied "unless it can be said with positive assurance that an arbitration clause is not susceptible of an interpretation which would cover the dispute at issue." *Id. quoting Wick v. Atlantic Marine, Inc.*, 605 F.2d 166, 168 (5th Cir. 1979). Thus, as a general rule, whenever the scope of an arbitration clause is in question, the court should construe the clause in favor of arbitration. *United Steelworkers of America v. Warrior & Gulf Navigational Co.*, 363 U.S. 574, 583, 80 S.Ct. 1347, 1353, 4 L.Ed.2d 1409 (1960). The Court, after reviewing the arbitration clause in this case, is of the opinion that it is more than sufficiently broad to cover all the claims involved in this cause of action.[1]

[1] The arbitration agreement in paragraph 13 reads as follows:

> "Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules then in effect, of the National Association of Securities Dealers, Inc. as I may elect. If I do not make my election by registered mail addressed to you at your main office within 5 days after demand by you that I make such election, then you may make such election. Judgment upon any award rendered by the arbitration may be entered in any court having jurisdiction thereof."

The Plaintiffs contend that the arbitration clause was fraudulently induced and thus cannot control the disposition of this case. In *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395, 87 S.Ct. 1801, 18 L.Ed.2d 1270 (1967), the United States Supreme Court dealt with the issue of whether fraudulent inducement can be brought before an arbitrator instead of district court. The Supreme Court reasoned that:

> If the claim is fraud in the inducement of the arbitration clause itself – an issue which goes to the 'making' of the agreement to arbitrate – the federal court *may* proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement generally . . . [A] federal court may consider only issues relating to the making and performance of the agreement to arbitrate.

Id. at 403-04, 87 S.Ct. at 1805-06.

The Seventh Circuit in *Schacht v. Beacon Ins. Co.*, 742 F.2d 386, 389 (7th Cir. 1984), reaffirmed this position and noted that only when the claimed contractual invalidity goes to the arbitration clause itself does the court decide the existence of a contractual provision. *See also Mar-Len of LA., Inc. v. Parsons-Gilbane*, 773 F.2d 633 (1985) (alleging fraud in the inducement of a modification to the original contract).

Although Plaintiffs, in their brief in Opposition to Motions to Dismiss and Compel Arbitration, purport to allege only fraud in the inducement of the arbitration clause itself, the Court sees nothing before it which would lead the Court to believe the alleged fraud in the inducement applied solely to the arbitration clause. To the contrary, in all the Plaintiffs' Affidavits in Opposition to Defendants' Motion to Stay, they stated that the "contracts" were not explained to them, and that they could not understand the technical Shearson "contract"; not just the arbitration clause. The Court believes that Plaintiffs cannot avoid the application of *Prima Paint* by simply alleging the fraud on the clause itself when the substance of the complaint reveals fraud on the whole contract. Accordingly, Plaintiffs' claim of fraud in the inducement must be resolved in the arbitral forum.

B) *The Securities Act Claims*

In *Wilco v. Swan*, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1958), the United States Supreme Court held that predispute agreements to arbitrate claims that arise under Securities Act of 1933 are not enforceable. The Court pointed to language in § 14 of the Securities Act of 1933, 15 U.S.C. § 77n, which declared "void" any "stipulation" waiving compliance with any "provision" of the Securities Act. The Supreme Court thus held that an agreement to arbitrate amounted to a stipulation waiving the right to seek a judicial remedy, and was therefore void. 346 U.S. at 434-435. Subsequent court decisions have preserved the vitality of this Supreme Court holding. *See Dean Witter Reynolds, Inc. v. Byrd*, 105 S.Ct. 1238, 1240 n.1 (1985); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823, 826-827 (10th Cir. 1979); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831 (7th Cir. 1977). Accordingly, the 1933 Securities Act claims cannot be arbitrated.

Although Defendants would fail on the 1933 Act claim, they would assert that the claims arising under § 10(b) of the Securities Exchange Act of 1934 are distinguishable and should not be governed by the *Wilco v. Swan* holding. In *Scherk v. Alberto Culvert Company*, 417 U.S. 506, 94 S.Ct. 2449, 41 L.Ed.2d 270 (1974), the Supreme Court failed to extend *Wilco* to § 10(b) claims. The Court stated that the provisions of the 1934 Act differed from those of the 1933 Act and thus the reasoning of *Wilco* was inapplicable.[2] Recently, in *Dean Witter Reynolds, Inc. v. Byrd*, 105 S.Ct. 1238 (1985), Justice White, in his concurrence, resurfaced the apparent difference between the two Acts but the Supreme Court's majority declined to directly resolve the question.

[2] The Supreme Court questioned the applicability of *Wilco* to a claim arising under § 10(b) of the Securities Exchange Act of 1934 because unlike the 1933 Act, the 1934 Act did not expressly give rise to a private cause of action. Additionally, since a cause of action under § 10(b) and Rule 106-5 is implied rather than express, the "waiver" provision under the 1933 Act would not be literally applicable.

Notwithstanding the doubts raised by the Supreme Court, the case law in the Fifth Circuit is clear on the issue of the arbitrability of the 1934 Act. The Court has consistently held that Congress intended these claims to be non-arbitrable. *See, e.g., Mayaja, Inc. v. Bodkin, et al.*, No. 85-2762, slip op. 671, 679 (5th Cir. October 17, 1986); *Bustamante v. Rotan Mosle, Inc.*, No. 86-2300, slip op. 339, 340 (5th Cir. October 17, 1986); *Smokey Greenhaw Cotton Co. v. Merrill Lunch, Pierce, Fenner & Smith, Inc.*, 785 F.2d 1274, 1275 n.1 (5th Cir. 1986); *Sibley v. Tandy Corp.*, 543 F.2d 540, 543 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977). Basing their decisions upon an extension of the Supreme Court's analysis in *Wilco v. Swan*, these opinions adhered to the view that the similarities between the 1933 Securities Act and the 1934 Exchange Act far outweighed any differences that might exist.

Additionally, Defendants would assert that the recent Supreme Court decision in *Mitsubishi Motors Corp. v. Solar Chrysler-Plymouth, Inc.*, 105 S.Ct. 3346 (1985) would diminish the vitality of its holding in *Wilco* and implicitly overrule the established precedent in the Fifth Circuit. Presented with this argument in *Mayaja, Inc. v. Bodkin, et al.*, No. 85-2762, slip. op. 671 (5th Cir. October 24, 1986), the Fifth Circuit declined to give it much consideration. Instead, it elected to follow the established precedent in the Circuit and held, absent a clearer statement from the Supreme Court on the issue, that the 1934 Exchange Act claims are not arbitrable. *Id.* at 679. This Court must follow the precedent set forth by the Fifth Circuit and rule that both the 1933 Securities Act claims and the 1934 Exchange Act claims are not arbitrable. Therefore, solely with regard to these claims, the Defendant's Motion to Compel Arbitration is hereby DENIED.

C) *The RICO Claims*

The question of whether private RICO claims may be arbitrated is the subject of a split of authority among the Circuit Courts. The Second Circuit, in *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986), *cert. granted*, 55 U.S.L.W. 3197 (U.S. Oct. 6, 1986) (86-44), held that no RICO claims were ever arbitrable, regardless of the predicate offenses

asserted. The Third Circuit, in contrast, held in *Jacobson v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*, 797 F.2d 1197 (3rd Cir. 1986) that RICO claims may be arbitrated when the offenses predicate to the required "pattern of racketeering activity" are arbitrable.[3] The Fifth Circuit, until its recent decision in *Mayaja, Inc. v. Bodkin*, No. 85-2762, slip op. 671 (5th Cir. October 24, 1986), had not expressly ruled on the issue.[4] In the decision, the Fifth Circuit held that private RICO claims must be submitted to arbitration if a valid clause encompasses the claims. *Id.*

In order for a statutory claim like the civil RICO statute to overcome the overriding federal policy in favor of arbitration, it is necessary to show that Congress intended the statutory claim to be non-arbitrable. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983). In reaching its decision in *Mayaja, Inc.*, the Panel relied on the legislative history of the civil RICO statute; specifically, section 1964(c), the treble damages provision. Finding nothing in the express intent of Congress, the Panel examined the underlying purpose of the statute to determine whether Congress implicitly intended that all such claims be non-arbitrable. The Panel then relied on the Supreme Court's examination in *Mitsubishi* of section 4 of the Clayton Act.[5] 105 S.Ct. at 3358-60. The Panel agreed with the Supreme

[3] Therefore, if the Third Circuit were controlling, and the predicate offenses alleged were separate acts of wire and mail fraud, the RICO claims founded under 18 U.S.C. § 1341 and § 1342 would be arbitrable. If, however, the Securities Act violations were the predicate offenses alleged, the claims would be non-arbitrable pursuant to *Wilco v. Swan* and subsequent decisions. *Supra.*

[4] In *Smokey Greenhaw Cotton, Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 785 F.2d 1274, 1280-82 (5th Cir. 1986), the Fifth Circuit addressed, in dicta, the issue of arbitrability of private RICO claims. On petition for rehearing en banc, the Court noted that its reasoning was called into question by *Mitsubishi*. The Court thereafter amended its opinion "to refuse to decide the arbitrability *vel non* of the plaintiff's RICO claim." *Id.* at 1282.

[5] The Panel reasoned that since the legislative history of section 1964(c) made repeated references to section 4 of the Clayton Act, these references to the Clayton Act could be adopted by reference to the purposes of the Clayton Act's treble damages provision.

Court's assessment that the treble damages provision served a crucial deterrent function. In citing *Mitsubishi* at 3359, however, they found that the "action . . . seeks *primarily* to enable an injured competitor to gain compensation for that injury." Therefore, since the deterrent function was secondary to the compensatory function, the statute would continue to serve both its remedial and deterrent functions "so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum." *Mayaja, Inc. v. Bodkin*, No. 85-2762, slip op. 671 (5th Cir. October 24, 1986) *citing Mitsubishi*, 105 S.Ct. at 3359-60. Having paralleled *Mitsubishi*'s analysis, the Panel found that the congressional purposes of compensation and deterrence underlying section 1964(c) may be fulfilled by arbitration of the RICO claims. Thus, there was no evidence that Congress implied that all RICO claims were non-arbitrable.

Following the precedent set forth in *Mayaja, Inc.*, the Court accordingly rules that Plaintiffs' RICO claims are arbitrable and that the Defendants' Motion to Compel Arbitration of these claims is hereby GRANTED.

D) *The Deceptive Trade Practices Act Claim*

There is no Texas case law authority which would definitively determine whether Plaintiffs' case under the Texas Deceptive Trade Practices Act can or cannot be arbitrated. However, in *Ommani v. Doctor's Associates, Inc.*, 789 F.2d 298, 300 (5th Cir. 1986), the Fifth Circuit stated that enforcement of an otherwise valid arbitration clause cannot be denied solely by virtue of the suggestion that a claim is also based on the Texas Deceptive Trade Practices Act. The Panel cited the U.S. Supreme Court decision in *Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852, 79 L.Ed.2d 1 (1984) for the proposition that states may not thwart the strong federal policy favoring arbitration. Although these statements are rather broad, the Court is persuaded that the Deceptive Trade claims can be arbitrated under the Federal Arbitration Act. Absent any clear Texas authority to the contrary, this Court is compelled to do so.[6] *See also Marley v.*

[6] Plaintiffs assert the novel argument that the contract provision in this case is self-limiting and the federal preemption doctrine would not be controlling.
(footnote continued)

Drexel Burnham, Inc., 566 F.Supp. 333 (N.D. Tex. 1983). Therefore, the Defendants' Motion to Compel Arbitration of the Texas Deceptive Trade Practices Act is hereby GRANTED.

E) *Motion To Dismiss The Section 17(a) Claims*

Although the Supreme Court has not ruled on the issue, the Fifth Circuit has clearly held that there is no private cause of action under Section 17(a) of the Securities Exchange Act of 1933. *Landry v. All American Assurance Company*, 688 F.2d 381 (5th Cir. 1982. The Court therefore concludes that Defendants' Motion to Dismiss under Rule 12(b)(6) (failure to state a claim upon which relief can be granted) is hereby GRANTED and the claims under § 17 be DISMISSED.

F) *The Stay Issue*

The Court hereby ORDERS that the non-arbitrable Securities Act claims proceed under this cause of action and those claims will not be stayed pending resolution of the arbitrable claims. *See Dean Witter Reynolds, Inc. v. Byrd*, 105 S.Ct. at 1245 (1985). Therefore, the Defendants' Motion to Stay Pending Arbitration will be DENIED with regard to the Securities Act claims. As only the Securities Act claims remain before this Court, all other claims asserted by Plaintiffs will be presented in arbitration.

It is so ORDERED.

DONE at Brownsville, Texas this 18th day of November, 1986.

/s/ Filemon B. Vela
FILEMON B. VELA
United States District Judge

(footnote continued)
The relevant provision states: "Unless unenforceable due to federal or state law, any controversy . . . shall be settled by arbitration." Even if the arbitration would be unenforceable under Texas law, the Court cannot concede that the provisions in the language of this contract would override the Federal Arbitration Act.

APPENDIX E

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS BROWNSVILLE DIVISION

OFELIA RODRIGUEZ DE QUIJAS, JOSE LUIS RODRIGUEZ, JOSE LUIS RODRIGUEZ MORENO, MARTHA LETICIA RODRIGUEZ MORENO, LUIS ALEJANDRO RODRIGUEZ MORENO AND BEATRIZ RODRIGUEZ	(	NO. B-85-360
Plaintiffs	(	
VS.	(	
SHEARSON/AMERICAN EXPRESS, INC., ITS SUCCESSORS AND ASSIGNS AND JON GRADY DEATON	(	
Defendants	(	

ORDER

CAME ON TO BE CONSIDERED the motion of Defendant Shearson/American Express to compel all of Plaintiffs' causes of action to be subjected to arbitration, and the Court, having considered same, is of the opinion that all of Plaintiffs' 1934 Securities Act Claims against Shearson/American Express should be submitted to arbitration but that Plaintiffs' claims under §12(2) of the 1933 Securities Act be litigated in Federal District Court and that a default judgment should be entered against Defendant Deaton, and accordingly, it is ORDERED, ADJUDGED AND DECREED as follows:

1. That Plaintiffs' 1933 Securities Act §12(2) claims remain in Federal District Court;

2. That all other of Plaintiffs' claims against Shearson/American Express be submitted to arbitration;

3. That Defendant Shearson/American Express submit the arbitrable claims to the appropriate arbitral forum within 30 days;

4. That default judgment be entered against Defendant Jon Grady Deaton and that a hearing be held on damages on the 31st day of July, 1987 at 9:00 o'clock A.M.;

5. That all other relief not expressly granted herein, be denied.

Signed for entry this 9th day of July, 1987.

JUDGE PRESIDING

TRUE COPY I CERTIFY
ATTEST:
JESSE E. CLARK, Clerk
By _____
Deputy Clerk

APPENDIX F

United States Court of Appeals
FOR THE FIFTH CIRCUIT

No. 87-2888

D.C. Docket No. CA-B-85-360

OPELIA RODRIGUEZ DE QUIJAS, ET AL.,

Plaintiffs-Appellees,

versus

SHEARSON/LEHMAN BROTHERS, INC.,
f/k/a SHEARSON/AMERICAN EXPRESS, INC.,
and JON GRADY DEATON,

Defendants-Appellants.

Appeal from the United States District Court for the Southern District of Texas

Before THORNBERRY, WILLIAMS, and DAVIS, Circuit Judges.

J U D G M E N T

This cause came on to be heard on the record on appeal and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the portion of the judgment of the District Court in this cause which denied directing arbitration of the Securities Act § 12(2) claims is reversed, and the cause is remanded to the District Court for further proceedings in accordance with the opinion of this Court.

IT IS FURTHER ORDERED that plaintiffs-appellees pay to defendants-appellants the costs on appeal, to be taxed by the Clerk of this Court.

May 31, 1988

ISSUED AS MANDATE: JUL 5 1988

Clerk, U.S. Court of Appeals, Fifth Circuit
By /s/ Sarah L. Holmes
Deputy
New Orleans, Louisiana

APPENDIX G

District Court Cases Addressing the Enforceability of Agreements to Arbitrate 1933 Act Claims Post-*McMahon*

A. Cases Holding 1933 Act Claims Arbitrable Based on *McMahon*

Second Circuit

DeKuyper v. A.G. Edwards & Sons, Inc., No. N-85-529 (D. Conn. Dec. 10, 1987)

Third Circuit

Kavouras v. Visual Products Systems, Inc., 680 F. Supp. 205 (W.D. Pa. 1988)

Ryan v. Liss, Tenner & Goldberg Securities Corp., 683 F. Supp. 480 (D.N.J. 1988)

Fifth Circuit

Baldwin v. Cowen & Company, No. H-86-4247 (S.D. Tex. Jan. 19, 1988)

Rosenblum v. Drexel Burnham Lambert, Inc., No. 87-1903 (E.D. La. Aug. 18, 1987)

Ninth Circuit

Staiman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 673 F. Supp. 1009 (C.D. Cal. 1987)

Tenth Circuit

Reed v. Bear, Stearns & Co., No. 88-2040-0 (D. Kan. Aug. 19, 1988) (LEXIS, Fedsec library, Courts file)

Adams v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,741 (W.D. Okla. April 21, 1988)

Jeppsen v. Piper, Jaffray & Hopwood, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 93,996 (D. Utah Aug. 16, 1988)

Eleventh Circuit

Aronson v. Dean Witter Reynolds, Inc., 675 F. Supp. 1324 (S.D. Fla. 1987)

Bender v. Prudential-Bache Securities, Inc., No. 87-8572-CIV-ZLOCH (S.D. Fla. Mar. 14, 1988)

Benoay v. E.F. Hutton & Company, No. 82-6709-Civ.-Paine (S.D. Fla. Jan. 8, 1988)

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Rocz v. Drexel Burnham Lambert, Inc., 743 P. 2d 971 (Ariz. App. 1987)

U.S. Optical Frame Co. v. Prudential-Bache Securities, Inc., No. 86-14071 (Cir. Ct. Fla. Sept. 28, 1987)

B. Cases Holding 1933 Act Claims Nonarbitrable Based on *Wilko*

Second Circuit

McCowan v. Dean Witter Reynolds, Inc., 682 F. Supp. 741 (S.D.N.Y. 1987)

Third Circuit

Abadian v. Drexel Burnham Lambert, Inc., No. 88-0186 (E.D. Pa. Aug. 4, 1988)(LEXIS, Fedsec library, Courts file)

Helfricht v. Jeffries & Co., No. 85-0466 (D.N.J. Oct. 8, 1987)(LEXIS, Fedsec library, Courts file)

FILED
OCT 20 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-385

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

OFELIA RODRIGUEZ DE QUIJAS, *et al.*,

Petitioners,

—v.—

SHEARSON/AMERICAN EXPRESS, INC.,
its successors and assigns,

Respondents.

BRIEF OF *AMICUS CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF *CERTIORARI*

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SECURITIES INDUSTRY ASSOCIATION

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-385

OFELIA RODRIGUEZ DE QUIJAS, *et al.*,

Petitioners,

—v.—

SHEARSON/AMERICAN EXPRESS, INC.,
its successors and assigns,

Respondents.

BRIEF OF *AMICUS CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF *CERTIORARI*

PRELIMINARY STATEMENT

The Securities Industry Association ("SIA") submits this brief as *amicus curiae* in support of the Petitioner, and urges this Court to issue a writ of *certiorari* to the United States Court of Appeals for the Fifth Circuit with respect to its opinion and judgment below in *Rodriguez De Quijas* v. *Shearson/Lehman Brothers*, 845 F.2d 1296 (5th Cir. 1988). The consents of petitioner Ofelia Rodriguez De Quijas and of respondent Shearson/American Express, Inc., have been obtained and the originals thereof have been filed with the Clerk of the Court.

INTEREST OF *AMICUS CURIAE*

SIA is the principal trade association of the securities industry, having as members more than five hundred and fifty securities firms in the United States and Canada. As such, it has a substantial interest in the extent to which agreements to arbitrate claims between securities firms and their customers may be enforced. Because arbitration is an efficient, fair, and economical manner of resolving disputes, most of SIA's members have agreed with many of their customers to arbitrate any controversies arising between them.

Certain of SIA's members are parties to cases pending in the lower federal courts that involve the issue presented on this petition. The procedural outcome of those actions will be affected by any decision taken by this Court on this petition. *Amicus curiae* therefore has a substantial interest in seeing this Court resolve whether agreements to arbitrate claims arising under Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2) (the "Securities Act"), are enforceable as valid contracts under Section 2 of the United States Arbitration Act, 9 U.S.C. § 2 (the "Arbitration Act"), as is the case with claims arising under the Securities Exchange Act of 1934, 15 U.S.C. § 78 (the "Exchange Act"). *Amicus* seeks to clarify and make uniform the law on this issue so that the enforceability of arbitration provisions in agreements with their customers can be predicted and relied upon. SIA has also filed briefs *amicus curiae* on the enforceability of agreements to arbitrate Exchange Act claims to this Court in *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213 (1985), and in *Shearson/American Express, Inc.* v. *McMahon*, ____ U.S. ____, 107 S.Ct. 2332 (1987), and has moved for leave to file a brief with respect to a petition raising the identical issue at bar here in *Dain Bosworth Incorporated* v. *Johnson*, No. 88-284.

REASONS FOR GRANTING A WRIT OF *CERTIORARI*

The issue this petition lays before the Court is whether predispute agreements to arbitrate claims arising under Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2) (the "Securities Act"), are enforceable. Last year, in *Shearson/American Express, Inc.* v. *McMahon*, ____ U.S. ____, 107 S.Ct. 2332 (1987), the Court held that agreements to arbitrate claims under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (the "Exchange Act"), were enforceable under the United States Arbitration Act, 9 U.S.C. §§ 1 *et seq.* (the "Arbitration Act"). *McMahon* rejected an argument based on *Wilko* v. *Swan*, 346 U.S. 427 (1953), that an agreement to arbitrate federal securities claims waives substantive rights bestowed by the federal securities laws and is therefore void under the nonwaiver provisions of those laws. In restricting *Wilko* to its peculiar facts, *McMahon* rejected both *Wilko's* general hostility to the arbitration process and its specific reasoning. *Amicus* now respectfully asks the Court to make the law in this area uniform by overruling *Wilko*.

SUMMARY OF ARGUMENT

The opinion of the United States Court of Appeals for the Fifth Circuit below, *Rodriguez De Quijas* v. *Shearson/Lehman Brothers*, 845 F.2d 1296 (5th Cir. 1988), held that predispute agreements to arbitrate Section 12(2) claims are enforceable as valid contracts under the Arbitration Act. It did so based on this Court's opinion in *Shearson/American Express* v. *McMahon* that such an agreement is not a waiver of compliance with the Exchange Act. Because *McMahon* totally rejected the analytical predicate of the decision in *Wilko*—that an agreement to arbitrate waives substantive rights—the Fifth Circuit interpreted *McMahon* as having effectively overruled *Wilko* and therefore did not feel constrained to follow *Wilko*.

The Fifth Circuit correctly recognized *Wilko*'s "obsolescence" in light of the *McMahon* decision. *Wilko* reflects the

suspicion courts once held of the arbitral process, as opposed to the congressionally enacted federal policy recognizing arbitration as an efficient means of resolving disputes. *See Shearson/American Express, Inc.* v. *McMahon*, 107 S.Ct. at 2340; *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985); *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984); *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U.S. 1 (1983). *Wilko* did not apply the correct standard for determining whether Section 12(2) repealed the Arbitration Act by implication, which standard has been stated by this Court in *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. 72 (1982), and *Morton* v. *Mancari*, 417 U.S. 535 (1974). Rather than searching for statutory language conflicting with the Arbitration Act or legislative history indicating congressional intent to repeal the Arbitration Act, *Wilko* overruled the substantive, congressional policies embodied in the Arbitration Act solely on the basis of its own conception of public policy.

A writ of *certiorari* is appropriate here because there exists a split in the Circuits. In contrast to the result here, the Second Circuit has held in *dictum* that *Wilko* remains good law because this Court did not explicitly overrule it in *McMahon*. *Chang* v. *Lin*, 824 F.2d 219, 222 (2d Cir. 1987). In addition, the Minnesota Court of Appeals in *Johnson* v. *O'Brien*, 420 N.W.2d 264 (Minn. App. 1988), *review denied*, No. C9-87-1784 slip op. (Minn. May 18, 1988), *petition for cert. filed sub nom. Dain Bosworth Incorporated* v. *Johnson*, No. 88-246, while recognizing *Wilko*'s "continuing validity" as "questionable" after *McMahon*, 420 N.W.2d at 267, still felt constrained to follow *Wilko*.

Such results as the Minnesota Court of Appeals reluctantly reached in *Johnson* v. *O'Brien* can only lead lower courts to stray from the rule laid down by this Court: that the Arbitration Act is valid except where Congress has expressed its intention, either in statutory language or legislative history, to repeal it. They may also encourage parties to cast ordinary broker-customer disputes in terms of Section 12(2) as a device to escape

arbitration, which would frustrate the substantive rights established by the Arbitration Act.

Amicus respectfully submits that the petition for *certiorari* should be granted in order to prevent chaos among the lower courts that are trying to define the scope and validity of the Arbitration Act.

POINT I

THE UNITED STATES ARBITRATION ACT MANDATES THAT ARBITRATION BE RECOGNIZED AS AN EFFICIENT AND WIDELY ACCEPTED MEANS OF RESOLVING BROKER-CUSTOMER DISPUTES IN THE SECURITIES INDUSTRY

The United States Arbitration Act provides that an agreement to arbitrate in a contract involving interstate commerce is valid to the same extent as any other contract. When Congress passed the Arbitration Act in 1925, it established a clear federal policy favoring the use of arbitration to resolve disputes. That policy marked a decisive shift from the hostility to arbitration then prevalent in the courts.

In its recent decisions, this Court has found occasion to recognize the policy behind the Arbitration Act. In *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, the Court observed:

> [W]e are well past the time when judicial suspicion of the desirability of arbitration and the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.

473 U.S. at 626-27. *Accord Moses H. Cone Memorial Hospital* v. *Mercury Constr. Corp.*, 460 U.S. at 24 (the Arbitration Act "is a congressional declaration of a liberal federal policy favoring arbitration . . . [and] questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration"); *Southland Corp.* v. *Keating*, 465 U.S. at 10 (in passing the Arbitration Act, "Congress declared a national pol-

icy favoring arbitration . . . [that] mandated the enforcement of arbitration agreements''); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-11 (1974). *See also Wilko* v. *Swan*, 346 U.S. at 439 (Frankfurter, J., dissenting) (''[t]here is nothing in the record . . . to indicate that the arbitral system . . . would not afford the plaintiff the rights to which he is entitled'').[1]

Since this Court has decisively abandoned both the analytical reasoning and the deep suspicion of arbitration that permeates the opinion in *Wilko* v. *Swan*, there is no reason that *Wilko* should hold sway even in the narrow space to which it is now restricted. *Wilko* is premised on a fundamental hostility to arbitration. *See Shearson/American Express, Inc.* v. *McMahon*, 107 S.Ct. at 2340. Proceeding from that premise, *Wilko* espoused the theory that an agreement to arbitrate Securities Act controversies waives substantive rights under that statute. Because Section 14 of the Securities Act, 15 U.S.C. § 77n, invalidates ''any . . . stipulation . . . to waive compliance with any provision'' of the Securities Act, and because the Court was suspicious that arbitration panels would not adequately enforce complaints with that Act, it therefore found predispute agreements to arbitrate Section 12(2) claims void.[2]

The decision in *Wilko* flatly ignored the substantive federal policy embodied in the Arbitration Act. In equating an agree-

1 The language in *Mitsubishi*, *Moses H. Cone*, and *Southland* echoes Justice Frankfurter's dissenting language in *Wilko*, 346 U.S. at 439, rather than the majority's concern in *Wilko* that arbitration of Section 12(2) claims would endanger the ''special rights'' created thereby, 346 U.S. at 435.

2 *Wilko's* language shows extraordinary cynicism as to the competence of arbitration tribunals:

> [A Securities Act] case requires subjective findings on the purpose and knowledge of an alleged violator of the Act. They must not only be determined but applied by the arbitrators without judicial instruction on the law. As the award may be made without explanation of their reasons and without a complete record of their proceedings, the arbitrators' conception of the legal meaning of such statutory requirements as ''burden of proof,'' ''reasonable care'' or ''material fact'' . . . cannot be examined.

346 U.S. at 435-36.

ment to arbitrate Securities Act controversies with a waiver of compliance with that Act, *Wilko* put the blind eye to Congress's unmistakable mandate that arbitration was to be a respected method of resolving disputes and that there was no public policy against agreements to arbitrate.

As this Court has recognized, its recent decisions substantially differ from *Wilko's* hostility to arbitration. For example, *McMahon* observed:

> It is difficult to reconcile *Wilko's* mistrust of the arbitral process with this Court's subsequent decisions involving the Arbitration Act.

107 S.Ct. at 2341. Moreover, this Court has twice rejected the predicate of the *Wilko* decision, the notion that an agreement to arbitrate controversies under a federal statute waives compliance with the provisions of that statute:

> By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits their resolution to an arbitral, rather than judicial forum. It trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.

Mitsubishi Motors Corp. v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. at 628; *accord, Shearson/American Express, Inc.* v. *McMahon*, 107 S.Ct. at 2339.

Not only did *McMahon* abandon *Wilko's* reasoning, it reached the exact opposite holding: for it held that an agreement to arbitrate claims arising under Section 10(b) of the Exchange Act was *not* a ''stipulation . . . to waive compliance with'' the Exchange Act, which is void under Section 29(a) of that Act, 15 U.S.C. § 78cc(a), whereas *Wilko* had held that such an agreement *was* a ''stipulation . . . to waive compliance with'' the Securities Act. Yet, although *McMahon* questioned *Wilko's* continuing vitality (''indeed most of the reasons given in *Wilko* have been rejected subsequently by the Court as a basis for holding claims to be nonarbitrable''), it nonetheless cautioned that ''*stare decisis* concerns may counsel against

upsetting *Wilko's* contrary conclusion under the Securities Act." 107 S.Ct. at 2341.

Wilko's inconsistency with the state of arbitration today in the securities industry not only explains but justifies this Court's reluctance to follow *Wilko's* holding or its policy pronouncements. The established structure of arbitration in the securities industry refutes *Wilko's* assumption that the enforcement of contracts to arbitrate securities disputes will dilute the protection of investors under the securities laws. Securities exchanges and the National Association of Securities Dealers, Inc. (the "N.A.S.D."), under the supervision of the Securities and Exchange Commission, provide arbitration facilities for disputes between member firms and their public customers.[3] The current procedures have evolved since 1872, when the New York Stock Exchange, Inc., first adopted arbitration procedures. The N.A.S.D. has maintained arbitration facilities for more than forty years. The exchanges and the N.A.S.D. also have permanent arbitration staffs. Their rules and constitutions contain detailed codes of arbitration procedures.[4]

Moreover, the Securities and Exchange Commission has approved the implementation and operation of this arbitral system, *see* Exchange Act Release No. 16390, S.E.C. (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979), and retains jurisdiction to monitor the fairness of arbitration proceedings. *See* Section 19 of the Exchange Act, 15 U.S.C. § 78s. As the Commission itself argued to this Court in *McMahon*, in a brief signed by its General Counsel and Solicitor:

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3 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542 (Rule 602); N.A.S.D. Manual (CCH) ¶ 3701; 2 N.Y.S.E. Guide (CCH) ¶ 2600 (Rule 600); Uniform Code of Arbitration § 1, *reprinted in* Fifth Report of the Securities Industry Conference on Arbitration (April 1986).

4 *See, e.g.*, Constitution of the New York Stock Exchange, Inc., Art VIII, 2 N.Y.S.E. Guide (CCH) ¶¶ 1351-1357; Rules 600-634 of the New York Stock Exchange, Inc., *id.* ¶¶ 2600-2634; Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., N.A.S.D. Manual (CCH) ¶¶ 3701-3743; Arbitration Rules of the American Stock Exchange, Inc., 2 Am. Stock Ex. Guide (CCH) ¶¶ 9540-9551J.

> [T]he Commission has had the power to ensure that arbitration procedures prescribed by the [Self-Regulatory Organizations] are adequate to enforce the rights of customers against brokerage firms that are members of SROs. In these circumstances, the suspicion of arbitration on which *Wilko* rested is inappropriate, and an agreement to arbitrate acccordingly should not be deemed a waiver of rights under the Exchange Act.

Shearson/American Express, Inc. v. *McMahon*, No. 86-44, Brief of the Securities and Exchange Commission as *amicus curiae* at 13.

The long established competence of securities industry arbitrators to adjudicate disputes should dispel any suspicion of the arbitral process in that industry. The stock exchanges and the N.A.S.D. keep permanent lists of arbitrators. These lists comprise senior securities industry personnel, attorneys, and other professionals from outside the industry, who are well versed in the field. *See, e.g.*, Panel of Arbitrators 1986-1987, 1 Am. Stock Ex. Guide (CCH) ¶¶ 157-59; N.A.S.D. Manual (CCH) ¶ 3702. Most have previously served as arbitrators and are therefore well acquainted with arbitration procedures and customs. Thus, this Court's observation in *Mitsubishi* that "adaptability and access to expertise are hallmarks of arbitration," 473 U.S. at 633, hits the mark with respect to the securities industry. As this Court stated after reviewing the state of arbitration in the securities industry in *McMahon*, "Even if *Wilko*'s assumptions regarding arbitration were valid at the time *Wilko* was decided, most certainly they do not hold true today. . . ." 107 S.Ct. at 2341.[5]

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5 Far from considering themselves as the only tribunal capable of hearing securities disputes, the federal courts have recognized securities industry arbitrators as qualified to resolve those claims. Courts have long compelled arbitration of Exchange Act disputes between members of a securities exchange or the N.A.S.D. *See, e.g.*, *Shearson/American Express, Inc.* v. *McMahon*, 107 S.Ct. 2332; *Axelrod & Co.* v. *Kordich, Victor & Neufeld*, 320 F. Supp. 193 (S.D.N.Y. 1970), *aff'd*, 451 F.2d 838 (2d Cir. 1971); *Brown* v. *Gilligan, Will & Co.*, 287 F. Supp. 766,

The arbitration rules of the N.A.S.D. and the various stock exchanges further ensure that arbitration practice in the securities industry will be efficient and impartial. For example, these rules require that panels of arbitrators include members of the securities industry and of the public.[6] They require a majority of "public" arbitrators (*i.e.*, unaffiliated with member firms) in disputes between public customers and member firms unless the customer requests otherwise.[7] Arbitrators are required to disclose any business affiliation with any parties before them, and may be disqualified for cause for even the appearance of a conflict of interest.[8] Each party in an arbitration has at least one peremptory challenge.[9]

The arbitration itself proceeds much like a trial. The parties have the right to be present at the hearing, to be represented by counsel, to cross-examine witnesses, and to take a transcript of the hearing. They may subpoena witnesses and documents just as in a court proceeding, and may also compel the presence of any employee of a member of the sponsoring institution at a hearing, regardless of whether that employee would be within the subpoena power of the courts of the state where the hearing

772 (S.D.N.Y. 1968). Claims under the Exchange Act are routinely arbitrated if the public customer chooses to arbitrate. *See Gardner* v. *Shearson, Hammill & Co.*, 433 F.2d 367 (5th Cir. 1970) (per curiam), *cert. denied*, 401 U.S. 978 (1971); *Moran* v. *Paine, Webber, Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968); *cf. AVC Nederland B.V.* v. *Atrium Inv. Partnership*, 740 F.2d 148 (2d Cir. 1984) (affirming the dismissal of an Exchange Act claim because the parties had agreed to try all disputes in the Netherlands).

6 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9541 (Rule 601); N.A.S.D. Manual (CCH) ¶ 3719; 2 N.Y.S.E. Guide (CCH) ¶ 2607 (Rule 607); Uniform Code of Arbitration § 8.

7 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542 (Rule 602); N.A.S.D. manual (CCH) ¶ 3719; 2 N.Y.S.E. Guide (CCH) ¶ 2607 (Rule 607); Uniform Code of Arbitration § 8.

8 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542(f) (Rule 602)(f); N.A.S.D. Manual (CCH) ¶ 3723; 2 N.Y.S.E. Guide (CCH) ¶ 2610 (Rule 610); Uniform Code of Arbitration § 11.

9 *See, e.g.*, Uniform Code of Arbitration § 10.

is held.[10] Moreover, arbitrators serve, and witnesses testify, under oath.[11] The fairness of these rules and procedures is borne out by the results of arbitrations conducted under them. In 1987, 55% of public customer cases that went to arbitration before one of the stock exchanges or the N.A.S.D. and were decided—rather than being settled—awarded damages to the customer.[12]

Moreover, the arbitration process significantly reduces discovery expenses and minimizes delay in reaching a hearing. *See Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. at 628; C. Katsoris, *The Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279, 286 (1984). For example, state laws generally provide subpoena power to arbitrators and counsel, and parties are encouraged to produce documents "to the fullest extent possible without resort to the issuance of the subpoena process."[13] Arbitrators may also direct the appearance of persons associated with member organizations or the production of records of these organizations without using the subpoena process.[14] That most stock exchanges and the

10 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶¶ 9546, 9548-49, 9551A (Rules 606, 608-09, 612); 2 N.Y.S.E. Guide (CCH) ¶¶ 2614-15, 2619-20, 2624 (Rules 614-15, 619-624); Uniform Code of Arbitration §§ 15-16, 20-21, 25.

11 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9551B (Rule 613); 2 N.Y.S.E. Guide (CCH) ¶ 2625 (Rule 625); Uniform Code of Arbitration § 26.

12 *See* Minutes of the June 24, 1988, Meeting of the Securities Industry Conference on Arbitration, which reported arbitration statistics for 1987 similar to those previously reported to the Securities and Exchange Commission. A table of these statistics, and of the 1986 statistics compiled by the Securities Industry Conference on Arbitration, is set forth in Appendix A.

13 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9548 (Rule 608); N.A.S.D. Manual (CCH) ¶ 3732; 2 N.Y.S.E. Guide (CCH) ¶ 2619 (Rule 619); Uniform Code of Arbitration § 20; C. Katsoris, *supra*, at 286.

14 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9549 (Rule 609); N.A.S.D. Manual (CCH) ¶ 3733; 2 N.Y.S.E. Guide (CCH) ¶ 2620 (Rule 620); Uniform Code of Arbitration § 21.

N.A.S.D. offer a streamlined arbitration procedure for smaller claims also enables customers to resolve small disputes without incurring great expense.[15] Arbitration also offers an expeditious result. According to statistics compiled by the Securities Industry Conference on Arbitration, nearly 4,364 securities industry arbitrations were filed with stock exchanges and the N.A.S.D. in 1987, and 2,936 arbitrations in the securities industry were resolved during that year.[16] The 1987 figures represent more than three times the number of arbitrations filed in 1982.[17]

Finally, the excessive caseload in the federal district courts makes it all the more important that arbitrable claims between securities firms and their customers proceed to arbitration. Filings of securities and commodities claims have increased to 2,844 in 1987.[18] Since the average caseload per United States District Judge in 1987 was 460 cases,[19] permitting agreements to arbitrate all securities laws claims would effectively create up to six new federal district judgeships, which would help to relieve the federal courts of their overloaded dockets.

Wilko thus stands bereft of any factual, legal, or policy support. *Amici* respectfully submit that *Wilko*'s defiance of congressional policy, its analytical inconsistency with this Court's more recent decisions, and its invalid factual assumptions take it out of the shelter of *stare decisis*. As the Court has long recog-

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15 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9551H (Rule 619); N.A.S.D. Manual (CCH) ¶ 3710; 2 N.Y.S.E. Guide (CCH) ¶ 2601 (Rule 601); Uniform Code of Arbitration § 2.

16 *See* Appendix A.

17 The number of filings rose from 1,340 in 1982 to 4,364 in 1987. *See* Fifth Report of the Securities Industry Conference on Arbitration Statistical Report (April 1986) (Exhibit A), which is reproduced in Appendix B to this Brief.

18 Annual Report of the Director of the Administrative Office of the United States Courts, Table C2 (1987). This table is reproduced in excerpted form as Appendix C to this Brief. These figures are calculated on the basis of a year beginning July 1; "1987" statistics therefore refer to the period July 1, 1986, through June 30, 1987.

19 Administrative Office of the United States Courts, Federal Court Management Statistics 1987 at 167.

nized, "*stare decisis*, in statutory construction, is a useful rule, not an inexorable command." *Erie Railroad Co.* v. *Tompkins*, 304 U.S. 64, 92 (1938) (Reed, J., concurring). Thus, the Court has overturned its own precedent in order to achieve consistency in interpreting statutory provisions. *See Commissioner* v. *Estate of Church*, 335 U.S. 632 (1949). The Court in *Church* reconsidered the construction of the "possession or enjoyment" clause under Section 811(c) of the Internal Revenue Code it had adopted in *May* v. *Heiner*, 281 U.S. 238 (1930). It did so because its subsequent decision in *Helvering* v. *Hallock*, 309 U.S. 106 (1940), had construed the same "possession or enjoyment" clause in Section 811(c) of the Code differently from *May*. *Church* found that the decision in *Hallock* amounted to a complete rejection of the rationale in *May*, even though it did not expressly overrule *May*. *Commissioner* v. *Estate of Church*, 335 U.S. at 643-45. While acknowledging the interests inherent in the doctrine of *stare decisis*, the Court overruled *May* in order to bring an inconsistent holding in line with its later decision. *See Commissioner* v. *Estate of Church*, 335 U.S. at 649-50. As stated in *Helvering v. Hallock*, where the Court was also confronted with incompatible decisions, the "real problem . . . is to determine whether we are to adhere to a harmonizing principle . . . or whether we are to multiply gossamer distinctions between the present cases and the . . . earlier ones." 309 U.S. at 118. Here, too, a holding that Section 12(2) claims are arbitrable would make the law with respect to those claims consistent with the law regarding Exchange Act claims.

Likewise, the Court has not hesitated to overrule decisions that "do not state the correct rule of law." *See Girouard* v. *United States*, 328 U.S. 61, 69 (1946) (overruling *United States* v. *Schwimmer*, 279 U.S. 644 (1929), *United States* v. *MacIntosh*, 283 U.S. 605 (1931), and *United States* v. *Bland*, 283 U.S. 636 (1931)). Here, again, where *Wilko*'s legal reasoning and policy consideration cannot pass muster under this Court's more recent Arbitration Act decisions, *Wilko* cannot "state the correct rule of law" and should therefore be overruled.

Last, should the Court overrule *Wilko*, it will bestow the additional policy advantage of making the law uniform for all securities law claims. Parties will have no incentive to continue to plead a Section 12(2) claim as a means of avoiding arbitration. The federal court system will therefore be spared substantial motion practice over pleading matters, as well as over difficult collateral estoppel issues that invariably arise when claims arising under the same set of facts must be resolved by different tribunals.

POINT II

WILKO V. *SWAN* IGNORED THE STANDARD FOR FINDING AN IMPLIED REPEAL OF THE UNITED STATES ARBITRATION ACT

By holding that Section 12(2) claims are not arbitrable on the basis of its own perception of arbitration practice, *Wilko* usurped Congress's role in setting federal policy. Specifically, while purporting to resolve a conflict between "two policies, not easily reconcilable", 346 U.S. at 438, *Wilko* in fact manufactured that conflict on the basis of its hostility to arbitration. Notwithstanding Congress's policy favoring arbitration, *Wilko* equated an agreement to arbitrate Securities Act claims with a waiver of compliance with the Securities Act in order to void such an agreement under Section 14.

Wilko's analysis stands at odds with many of this Court's rulings, in particular *McMahon* and *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc. Mitsubishi* requires that any finding of an implied repeal of the Arbitration Act be supported by "congressional intention expressed in some other statute . . . ." 473 U.S. at 627. This is simply a reiteration of the traditional standard for finding that a federal statute has been repealed by implication by a subsequently enacted federal statute. *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. at 88 (" 'repeals by implication [of a prior statute by a subsequently enacted one] are disfavored' ") (quoting *Allen* v. *McCurry*, 449 U.S. 90, 99 (1980)); *Morton* v. *Mancari*, 417 U.S. at 550 ("In the

absence of some affirmative showing of an intention [by Congress] to repeal, the only permissible justification for a repeal by implication is when the earlier and later statutes are irreconcilable").

In *Mitsubishi*, this Court stated:

> We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history.

473 U.S. at 628.[20]

Under this test, there can be no question that predispute agreements to arbitrate Section 12(2) claims are enforceable under the Arbitration Act. The Securities Act contains no statutory language that restricts a party's ability to choose an arbitral forum with respect to claims brought thereunder. Section 14, on which *Wilko* relied, concerns waivers of compliance with the Securities Act, not agreements as to what forum a claim under the Securities Act may be tried before. This Court has already marked this distinction in *Mitsubishi* and *McMahon* to the extent of holding that Section 29 of the Exchange Act, a nonwaiver provision substantially identical to Section 14, did not void agreements to arbitrate in *McMahon*.

Nor is there any evidence in the legislative history of the Securities Act that Congress intended to repeal the Arbitration Act with respect to Securities Act claims. That Congress in amending the securities laws in 1975 did not act to overrule *Wilko* has no bearing on what Congress intended in 1933, the critical inquiry at bar. Nor does the fact that the Conference Report for those amendments observed that they were not intended to disturb existing law as to waiver of claims and cited *Wilko* v. *Swan*. *See* H.R. Conf. Rep. No. 94-229, at 111 (1975),

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20 The opinion in *Mitsubishi* cited *Wilko* v. *Swan* for this proposition, in spite of the fact that *Wilko* did not rely on text or legislative history, but rather on its hostile view of arbitration practice and its conception of an agreement to arbitrate statutory claims as a waiver of compliance with the statute in question, both of which notions *Mitsubishi* rejected in no uncertain terms.

reprinted in 1975 U.S. Code Cong. & Ad. News, at 179, 342. The Court in *McMahon* found the language quoted from that Conference Report so obscure as not to be probative of anything, with the result that "the *Wilko* issue was left to the courts." 107 S.Ct. at 2343. Moreover, such subsequent legislative inaction will not prevent a Court from revisiting a decision that was ill-founded, as *amici* respectfully suggest is the case here. For example, in *Girouard* v. *United States*, the Court overruled its prior interpretation of a statute after Congress had rejected amendments to that statute that would have overruled the prior interpretation. *See* 328 U.S. at 72-76 (Stone, C. J., dissenting). As the majority held, "it is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law. We do not think under the circumstances of this legislative history that we can properly place on the shoulders of Congress the burden of the Court's own error." 328 U.S. at 69-70.

Absent specific legislative evidence to the contrary, the Arbitration Act must apply to Securities Act claims and agreements to arbitrate those claims must be honored as ordinary contracts.

POINT III

THE CIRCUITS STAND IN CONFLICT AS TO THE ARBITRABILITY OF SECURITIES ACT CLAIMS

A direct conflict now exists among the Circuits with respect to whether a predispute agreement to arbitrate claims arising under the Securities Act is enforceable. The decision below directly conflicts with the decision of the Second Circuit in *Chang* v. *Lin*, 824 F.2d 219, 222 (2d Cir. 1987), albeit in *dictum*, that *Wilko* is still valid because it was not expressly overruled in *McMahon*.[21] In addition, in a case where a petition for

21 In addition to this case, the Tenth Circuit has recognized in *dictum* that "*McMahon* . . . essentially overruled *Wilko* . . . ." *Peterson* v. *Shearson/American Express, Inc.*, 849 F.2d 464, 466 (10th Cir.). A split also exists among the district courts which have considered the issue. At least five reported decisions have held that *McMahon* effectively overruled *Wilko*, thus allowing for the arbitration of claims under the Securities Act: *Ryan* v. *Liss, Tenner & Goldberg*, 683 F. Supp. 480 (D.N.J. 1988); *Kavouras* v. *Visual Products Systems, Inc.*, 680 F. Supp. 205 (W.D. Pa. 1988); *Aronson* v. *Dean Witter Reynolds, Inc.*, 675 F. Supp. 1324 (S.D. Fla. 1987); *Staiman* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 673 F. Supp. 1009 (C.D. Cal. 1987); *Jeppsen* v. *Piper, Jaffray & Hopwood, Inc.*, [Current] Fed. Sec. L. Rep. ¶ 93, 996 (D. Utah August 16, 1988). Seven other courts have refused to overrule *Wilko*. *See Abadian* v. *Drexel Burnham Lambert*, No. 88-0186 (E.D. Pa. August 4, 1988) (LEXIS, Genfed library, Dist file); *Araim* v. *PaineWebber, Inc.*, No. 1:88-CV-73-JOF (N.D. Ga. June 21, 1988) (LEXIS, Genfed library, Dist file); *McCullogh* v. *Shearson Lehman Brothers, Inc.*, No. 86-2752 (W.D. Pa. February 18, 1988) (LEXIS, Genfed library, Dist file); *Ketchum* v. *Almahurst Bloodstock IV*, 685 F. Supp. 786 (D. Kan. 1988); *McCowan* v. *Dean Witter Reynolds, Inc.*, 682 F. Supp. 741 (S.D.N.Y. 1987); *Schultz* v. *Robinson-Humphrey/American Express, Inc.*, 666 F. Supp. 219 (M.D. Ga. 1987); *Continental Service Life & Health Ins. Co.* v. *A.G. Edwards & Sons, Inc.*, 664 F. Supp. 997 (M.D. La. 1987).

a writ of *certiorari* is now pending before this Court, the Court of Appeals of Minnesota, while recognizing that *Wilko*'s "continuing validity" is "questionable" in light of *McMahon*'s unequivocal rejection of its analytical and policy bases, still felt constrained to follow *Wilko*'s *result* until this Court affirmatively overrules *Wilko*. *Johnson* v. *O'Brien*, 420 N.W.2d 264 (Minn. App. 1988), *review denied*, No. C9-97-1784 slip op. (Minn. 1988), *petition for cert. filed sub nom. Dain Bosworth Incorporated* v. *Johnson*, No. 88-246.

CONCLUSION

For the reasons set forth above, *amicus curiae* the Securities Industry Association, respectfully requests that the petition for a writ of *certiorari* be granted.

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SECURITIES INDUSTRY ASSOCIATION

APPENDIX A

1987—ARBITRATION STATISTICS FOR SELF-REGULATORY ORGANIZATIONS AS COMPILED BY THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION

	Total Cases Received	Total Cases Concluded Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards In Favor Of Public	Cases Carried Into 1988
American Stock Exchange, Inc.	123	72	36	26	38	24	48
Boston Stock Exchange, Inc.	0	0	0	0	0	0	0
Chicago Board Options Exchange	130	93	29	33	22	9	53
Cincinnati Stock Exchange, Inc.	0	0	0	0	0	0	0
Midwest Stock Exchange, Inc.	5	3	1	1	1	1	2

1986—ARBITRATION STATISTICS FOR SELF-REGULATORY ORGANIZATIONS AS COMPILED BY THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION

	Total Cases Received	Total Cases Concluded Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards In Favor Of Public	Pending
American Stock Exchange, Inc.	63	40	18	17	31	14	24
Boston Stock Exchange, Inc.	2	2	2	2	2	0	0
Chicago Board Options Exchange	72	44	16	9	12	9	28
Cincinnati Stock Exchange, Inc.	0	0	0	0	0	0	0
Midwest Stock Exchange, Inc.	4	0	1	0	0	0	6

A2

1987—ARBITRATION STATISTICS FOR SELF-REGULATORY ORGANIZATIONS AS COMPILED BY THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION

	Total Cases Received	Total Cases Concluded Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards In Favor Of Public	Cases Carried Into 1988
Municipal Securities Rule-Making Board	106	91	38	34	42	24	69
National Association of Securities Dealers, Inc.	2,886	1,625	458	325	642	364	*
New York Stock Exchange, Inc.	1,050	1,000	225	204	378	200	842
Pacific Stock Exchange, Inc.	64	52	27	11	23	13	64
Philadelphia Stock Exchange, Inc.	*	*	*	*	*	*	*
Total	4,364	2,936	814	634	1,146	635	1,078

A3

* Figure Unavailable.

1986—ARBITRATION STATISTICS FOR SELF-REGULATORY ORGANIZATIONS AS COMPILED BY THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION

	Total Cases Received	Total Cases Concluded Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards In Favor Of Public	Pending
Municipal Securities Rule-Making Board	82	68	28	20	39	15	61
National Association of Securities Dealers, Inc.	1,587	1,199	390	327	476	248	1,840
New York Stock Exchange, Inc.	965	1,004	181	205	432	210	792
Pacific Stock Exchange, Inc.	41	37	9	13	18	8	58
Philadelphia Stock Exchange, Inc.	22	15	10	6	7	2	2
Total	2,838	2,409	655	599	1,017	506	2,830

A4

APPENDIX B

Fifth Report of the Securities Industry Conference on Arbitration Statistical Report (April 1986) (Exhibit A)

COMPOSITE ARBITRATION FIGURES

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	830	686	332	269	410	205
1981	1,042	980	306	357	532	264
1982	1,340	1,044	322	292	558	293
1983	1,731	1,259	416	320	622	331
1984	2,449	1,762	561	489	736	366
1985	2,796	2,190	664	520	961	530

A5

AMERICAN STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	45	41	18	11	35	16
1981	39	40	7	11	42	22
1982	37	31	9	4	16	10
1983	41	42	14	8	10	6
1984	69	53	16	14	45	26
1985	64	58	21	14	41	24

Cases carried over into 1986: 29

A6

BOSTON STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	2	2	2	2	2	0
1981	2	2	2	2	0	0
1982	1	1	1	1	1	1
1983	2	2	2	2	2	1
1984	0	0	0	0	0	0
1985	0	0	0	0	0	0

Cases carried over into 1986: 0

A7

CHICAGO BOARD OPTIONS EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	44	31	11	11	18	6
1981	41	32	8	8	12	3
1982	50	38	6	6	14	3
1983	75	45	5	4	13	6
1984	91	56	24	16	4	3
1985	64	38	10	5	0	0

Cases carried over into 1986: 26

A8

CINCINNATI STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	0	0	0	0	0	0
1982	0	0	0	0	0	0
1983	0	0	0	0	0	0
1984	0	0	0	0	0	0
1985	0	0	0	0	0	0

Cases carried over into 1986: 0

A9

MIDWEST STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	2	2	1	0	1	1
1981	2	2	0	0	0	0
1982	1	0	0	0	0	0
1983	2	2	0	0	0	0
1984	1	0	0	0	0	0
1985	1	0	0	0	0	0

Cases carried over into 1986: 2

A10

MUNICIPAL SECURITIES RULEMAKING BOARD

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	21	21	7	7	3	2
1981	25	25	5	5	7	4
1982	33	30	7	7	13	6
1983	78	39	17	9	14	5
1984	113	77	20	17	34	21
1985	91	112	31	35	54	31

Cases carried over into 1986: 60

A11

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	318	234	134	113	122	56
1981	422	422	142	177	242	118
1982	606	435	157	139	276	140
1983	768	549	216	147	272	161
1984	1,108	747	298	244	381	196
1985	1,400	962	377	250	434	232

Cases carried over into 1986: 1,452

A12

NEW YORK STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	367	327	131	110	221	119
1981	477	433	117	134	214	111
1982	558	473	109	113	214	118
1983	713	532	136	122	276	137
1984	1,008	796	176	183	259	113
1985	1,095	962	198	190	424	221

Cases carried over into 1986: 831

A13

PACIFIC STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	24	28	12	11	4	3
1981	24	20	17	17	9	5
1982	31	21	15	11	10	7
1983	35	29	17	17	23	10
1984	45	26	21	11	10	7
1985	50	40	12	18	20	12

Cases carried over into 1986: 54

A14

PHILADELPHIA STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	7	0	16	4	4	2
1981	10	6	6	3	6	1
1982	23	15	18	11	14	8
1983	17	19	9	11	12	5
1984	14	7	6	4	3	0
1985	31	18	15	8	8	2

Cases carried over into 1986: 14

A15

APPENDIX C

EXCERPTS FROM TABLE C 2.—U.S. DISTRICT COURTS CIVIL CASES COMMENCED, BY BASIS OF JURISDICTION AND NATURE OF SUIT DURING THE TWELVE MONTH PERIODS ENDED JUNE 30, 1986 AND 1987

Nature of Suit	1986	1987					
		Total	U.S. Cases		Private Cases		
			Plaintiff	Defendant	Federal Question	Diversity of Citizenship	Local Jurisdiction
Total Cases	254,838	238,982	42,653	29,369	99,301	67,071	588
Contract Actions	88,352	69,540	28,749	868	6,988	32,840	95
Real Property Actions	10,674	11,585	5,836	904	733	4,072	40
Tort Actions, Total	42,326	42,947	190	3,145	9,180	30,098	334
Personal Injury	38,248	39,146	88	2,867	8,101	27,769	321
Personal Property Damage	4,078	3,801	102	278	1,079	2,329	13
Actions Under Statutes, Total	113,392	114,836	7,876	24,449	82,383	59	69
Antitrust	877	785	21	6	758	-	-
Bankruptcy	4,561	4,701	97	67	4,537	-	-
Banks and Banking	518	520	120	77	323	-	-

EXCERPTS FROM TABLE C 2.—U.S. DISTRICT COURTS CIVIL CASES COMMENCED, BY BASIS OF JURISDICTION AND NATURE OF SUIT DURING THE TWELVE MONTH PERIODS ENDED JUNE 30, 1986 AND 1987—(Cont'd)

Nature of Suit	1986	1987					
		Total	U.S. Cases		Private Cases		
			Plaintiff	Defendant	Federal Question	Diversity of Citizenship	Local Jurisdiction
Civil Rights	20,128	19,785	668	1,775	17,342	-	-
Commerce (ICC Rates, Etc.)	922	1,063	67	7	989	-	-
Economic Stabilization Act	12	17	1	6	10	-	-
Environmental Matters	641	702	291	139	270	2	-
Deportation	199	172	-	155	17	-	-
Prisoner Petitions	33,765	37,316	12	4,507	32,779	-	18
Forfeiture and Penalty	3,480	3,493	3,345	148	-	-	-
Labor Laws	12,839	12,746	1,093	185	11,468	-	-
Protected Property Rights	5,681	5,514	20	17	5,477	-	-
Securities, Commodities, and Exchanges	3,059	3,020	165	11	2,844	-	-
Social Security Laws	14,407	13,322	81	13,241	-	-	-

EXCERPTS FROM TABLE C 2.—U.S. DISTRICT COURTS
CIVIL CASES COMMENCED, BY BASIS OF JURISDICTION AND NATURE OF SUIT
DURING THE TWELVE MONTH PERIODS ENDED JUNE 30, 1986 AND 1987—(Cont'd)

Nature of Suit	1986	1987					
			U.S. Cases		Private Cases		
		Total	Plaintiff	Defendant	Federal Question	Diversity of Citizenship	Local Jurisdiction
State Reapportionment Suits	10	3	–	–	3	–	–
Tax Suits	2,750	2,784	913	1,823	–	–	48
Customer Challenge	57	40	–	40	–	–	–
Freedom of Information Act	505	444	–	405	39	–	–
Constitutionality of State Statutes	336	318	5	8	302	–	3
Other Statutory Actions	8,645	8,091	977	1,832	5,225	57	–
Other Actions, Total	84	74	2	3	17	2	50
Domestic Relations	6	4	–	–	–	–	4
Insanity	–	–	–	–	–	–	–
Probate	–	–	–	–	–	–	–
Other	78	70	2	3	17	2	46

Supreme Court, U.S.
FILED
DEC 29 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-385

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

OFELIA RODRIGUEZ DE QUIJAS, et al.,

Petitioners,

v.

SHEARSON/AMERICAN EXPRESS, INC.,

Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

JOINT APPENDIX

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Petition For Certiorari Granted November 14, 1988

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Subject: P.C. FED. CASE NO. 87-2888

Circuit 5 Appeal from Southern District of Texas at Brownsville.
Date docketed 8-17-87, $65 fee paid DC 8/14/87,
Judge Filemon B. Vela,
Date Notice of Appeal filed 8-11-87,
D.C. Docket Number CA-B-85-360,
Reporter William G. Holloway.

OPELIA RODRIGUEZ DE QUIJAS, ET AL.,

Plaintiffs-Appellees,

versus

SHEARSON/LEHMAN BROTHERS, INC., f/k/a SHEARSON/AMERICAN EXPRESS, INC., and JON GRADY DEATON,

Defendants-Appellants.

(CONSOLIDATED WITH Nos. 87-2889-90 and 91)

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No. 87-2888
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Returned from SA: 1-6-88 Class 3.
Submitted to Judge: (initials/code: JAPR), date: 1-6-88
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SPECIAL NOTATIONS

Location of Hearing: W.
Date of Hearing: 3-7-88.
Hearing Panel: HT-JSW-WED

8-18-87 See Nos 87-2889, 2890 & 2891

12-1-87 Record exc. not on shelf when case screened/MR

1-19-88 Assign 1st up on 3-7-88 per request of counsel for appellant, Mr. Krebsbach.

Title: DEQUIJAS, ET AL., -vs- SHEARSON/AMERICAN EXPRESS INC., Etc., No. 87-2888

RECORD, EXHIBITS AND BRIEF INFORMATION

9-2-87 Record on Appeal, No. of Vols.: 1

11-3-87 Records Excerpts – Appellant
Also filed 87-2890 et al.

11-3-87 Brief for Appellant
Also filed 87-2890, et al.

11-27-87 Brief for Appellee
Also filed 87-2889 et al.

12-21-87 Reply Brief for Appellant (SA)
Also filed 87-2889 et al.

MISCELLANEOUS FILINGS

8-17-87 Dup. Notice of Appeal and Clerk's Statement of Docket Entries

EXTENSION Flg. Motion for:

10-5-87 Appellant's Brief (*s.8) – Ext. to 11-3-87

12-9-87 Reply Brief (Copy to S.A.) – Ext. to 12-21-87

CALENDAR INFORMATION Week of 3-7-88

Summary Panel:
1-29-88 Case Assigned for 3-7-88 in W

Hearing Panel: HT-JSW-WED.
3-7-88 Case Argued by Appellant, by Appellee

OPINION INFORMATION, 4 print pages

5-31-88 Opinion Rendered
Also filed in 87-2889, 87-2890 and 87-2891

JSW Reversed, Signed.

REHEARING INFORMATION

6-9-88	Petition for Rehearing (J) Also filed 87-2889, 87-2890 & 87-2891 Appellees, Reg.
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10-3-87	Consolidate Appeals with 87-2889, 87-2890 & 87-2891
10-3-87	Granted by Clerk REW

JUDGMENT OR MANDATE INFORMATION

6-8-88	Bill of Costs Also filed 87-2889.
5-31-88	Filing & Entering Judgment
7-5-88	Judgment as Mandate Issued to Clerk
7-5-88	Record on Appeal Returned to Clerk: 1 vol.

SUPREME COURT INFORMATION #88-385

9-16-88	Notice of filing of Cert. Pet. on 9-1-88 Also filed 87-2888 to 2891
11-18-88	Order of Supreme Court, Granted

Supreme Court, U.S.
FILED
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JOSEPH F. SPANIOL, JR.
CLERK

(5)

No. 88-385

In The

Supreme Court of the United States

October Term, 1988

OFELIA RODRIGUEZ de QUIJAS, ET AL,

Petitioners,

vs.

SHEARSON/AMERICAN EXPRESS, INC.,
ITS SUCCESSORS AND ASSIGNS,

Respondents.

BRIEF OF PETITIONERS

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QUESTIONS PRESENTED

1. Are claims under Section 12(2) of the 1933 Securities Act now arbitrable under predispute broker contracts?

2. If such claims are now arbitrable, may these Petitioners be compelled to submit such claims to arbitration pursuant to terms of a predispute contract executed at a time when Section 12(2) claims were clearly not subject to arbitration?

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 845 F.2d 1296. The order of the court of appeals denying petitioners' motion for rehearing en banc is reported at 850 F.2d 1582. The opinion of the United States District Court is unreported. All opinions are reproduced in the Appendix to the Petition for Certiorari.

JURISDICTION

The judgment of the court of appeals was entered on May 31, 1988 and motion for rehearing was denied on June 22, 1988. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1) (1982).

STATUTORY AND REGULATORY PROVISIONS INVOLVED*

United States Arbitration Act
- Section 2, 9 U.S.C. § 2
- Section 3, 9 U.S.C. § 3

Securities Act of 1933
- Section 12(2), 15 U.S.C. § 77l(2)
- Section 14, 15 U.S.C. § 77n
- Section 22(a), 15 U.S.C. § 77v(a)

Securities Exchange Act of 1934
- Section 10(b), 15 U.S.C. § 78j(b)
- Section 27, 15 U.S.C. § 78aa
- Section 29(a), 15 U.S.C. § 78cc(a)

STATEMENT OF THE CASE

Petitioners are part of a group of some seventeen first-time investors, most of who filed complaints in federal district court, Southern District of Texas, Brownsville

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* The text of these provisions is reproduced in full at Appendix A.

Division. A number of those complaints not directly involved here, are presently in such district court awaiting the outcome of this case.

All complaints are factually similar. Petitioners were minors, individuals without the ability to understand English, terminal cancer victims, recently widowed women or retirees. Life savings were withdrawn from bank accounts. Such investors had the most conservative investment needs. Each investor dealt with a Shearson broker named Jon Grady Deaton. Typically each was asked to sign a preprinted Shearson document which was presented face down. The portion facing the investor had two check marks where the investor was told to sign. On the side of the document facing down, in the last paragraph which began with a discussion of "successors," appeared not only an arbitration provision, but also a choice of law election. No explanation of any of the terms of these documents was attempted. Copies were not usually provided although frequently requested. The broker ultimately placed each investor in high risk, over-the-counter stock, wherein Respondent was frequently a market-maker and whose inherent investment risks were further magnified when each investor was placed on margin. All investors lost a significant portion or all of their life savings. Every trade was initiated by the broker. All investors repeatedly complained that the Shearson monthly statements were totally unintelligible. In every case the response was that the investor simply had to trust the broker. One of these Petitioners alleges that the broker came to her residence to explain her monthly statements and then committed a sexual assault. None of the investors was aware that the broker's supervisor frequently lent the broker large sums of money and had guaranteed a third-party investment loan of some $165,000.00. Nor was any investor aware that during the period of the investments the broker owed Respondent almost $195,000.00. When the broker disappeared in June of 1985, the status of the account of each Petitioner finally became known. Investors alleged causes of action under state common law, including sexual assault, and under

federal and state statutes. Initially complaints under § 12(2) of the 1933 Securities Act were ordered to be tried in federal district court, however the opinion of the Fifth Circuit Court of Appeals, which is the subject of this petition for certiorari, determined that such § 12(2) claims could be arbitrated.

Petitioners have never conceded that the customer documents which apparently each Petitioner signed are valid or enforceable and each Petitioner has further asserted that the district court, with jury, should try those basic contract issues.

Pursuant to the district court's order of November 18, 1986, Respondent submitted all claims with the exception of the § 12(2) claims, to arbitration. Default judgments were entered against the broker and he is not a party to this petition.

SUMMARY OF ARGUMENT

Under *Wilko v. Swan*, 346 U.S. 427 (1953), § 12(2) 1933 Securities Act claims may never be subjected to compulsory arbitration pursuant to pre-dispute broker contracts. Unless *Wilko* is expressly overruled by this Court or the relevant federal statutes are amended, Petitioners' § 12(2) claims must be litigated. Further, it is Respondent's burden to convince this Court that *Wilko* should be overruled.

Wilko should not be overruled for both statutory-specific policy reasons and for wider constitutional policy reasons. The legislative intent of the 1933 Act was definitively interpreted in *Wilko* to preclude forced arbitration of § 12(2) claims. The *Wilko* ratio, as reflected consistently in dozens of law review analyses and several hundred reported and unreported case opinions, including several of this Court, was that the forced arbitration of § 12(2) claims was not permissible because of the intent of Congress expressed in the 1933 Securities Act. Compulsory arbitration pursuant to a pre-dispute contract was determined to be *inherently* inconsistent with

such Congressional intent. There was no discussion in *Wilko* as to *quality* of then-extant arbitration proceedings.

Not only do Petitioners dispute the *relevance* of quality changes in arbitration recently suggested by this Court, Petitioners also dispute the *quantum* of improvement which Respondent, the Securities Industry, and various arbitration groups have alleged.

Wilko should not be overruled because this Court should not reverse itself on matters of federal statutory interpretation since Congress is always free to reverse federal legislative interpretation through the legislative amendment process. Petitioners' case does not present constitutional claims which are innately or practically beyond Congressional reformation.

Petitioners will also argue that if *Wilko* were to be, in effect, overruled, that such action should be taken only with respect to the *sophisticated* investor.

Finally, Petitioners will argue that either as a matter of contractual intent or as a matter of sound judicial policy that any alteration of *Wilko* should be made *prospective* only.

ARGUMENT

I. RESPONDENT HAS THE BURDEN OF PROOF IN THIS CASE

The conventional analytical thesis which has been accepted is that in *Wilko* there existed two federal statutes which were viewed in 1953 by the majority of that Court as being difficult to reconcile. Upon examination of relevant statutory provisions and relevant legislative histories, the later 1933 Securities Act was deemed to render invalid a pre-dispute agreement to arbitrate 12(2) claims.

The threshold and weighty task for Respondent[1] is to show that the *Wilko* court was wrong either because its

[1] "The doctrine of stare decisis imposes a severe burden on the litigant who asks us to disavow one of our precedents. For that doctrine not only plays an important role in our orderly adjudication, it also serves the broader societal interests in even-handed, consistent and predictable application of legal rules"; *Thomas v. Washington Gas Light Co.*, 448 U.S.261, 272 (1980).

analytical process was wrong or because the process, though technically legitimate, was somehow imperfectly utilized, and then if either have been established, to *further* demonstrate that any judicial error thus exposed must be done away with by suspending the operation of stare decisis.

II. SECTION 12(2) CLAIMS ARE NOT SUBJECT TO PRE-DISPUTE ARBITRATION AGREEMENTS ABSENT CONGRESSIONAL AMENDMENT

1. *Wilko* Adopted the Correct Analytical Framework For Integrating The Two Federal Statutes Involved In This Case.

The *Wilko* majority opinion has been viewed as having decided that case on the analytical framework set forth in the majority's final paragaraph where the Court wrote as follows:

> Two policies, not easily reconcilable, are involved in this case. Congress has afforded participants in transactions subject to its legislative power an opportunity generally to secure prompt, economical and adequate solution of controversies through arbitration if the parties are willing to accept less certainty of legally correct adjustment. On the other hand, it has enacted the Securities Act to protect the rights of investors and has forbidden a waiver of any of those rights. Recognizing the advantages that prior agreements for arbitration may provide for the solution of commercial controversies, we decide that the intention of Congress concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration of issues arising under the Act. [footnote omitted]

Wilko, 346 U.S. at 438.

In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 627 (1985) (citing *Wilko*) the Court endorsed the above analytical framework stating that:

> "Just as it is the congressional policy manifested in the Federal Arbitration Act that requires courts liberally to construe the scope of arbitration agreements covered by that Act, it is the congressional

intention expressed in some other statute on which the courts must rely to identify any category of claims as to which agreements to arbitrate will be held unenforceable."

Further, in Shearson/American Express v. McMahon, 482 U.S. ___, 107 S.Ct. 2332, 2338 (1987) the majority opinion, in reference to the 1934 Securities and Exchange Act, 15 U.S.C. § 78a et. seq. (1982) also stated:

> "To defeat application of the Arbitration Act in this case, therefore, the McMahons must demonstrate that Congress intended to make an exception to the Arbitration Act for claims arising under RICO and the Exchange Act, an intention discernible from the text, history, or purposes of the statute."

Under this Wilko framework, a final determination is made as to the Congressional intent of each statute through its "text or legislative history." See *McMahon*, 107 S. Ct. at 2337 (quoting *Mitsubishi* at 628). The requisite analysis and determination have already been made with respect to the arbitrability of 12(2) claims. Since *McMahon* so recently validated the process[2] used in *Wilko*, if 12(2) claims are now to be rendered arbitrable, absent Congressional amendment, such change must be effected through a re-examination of legislative intent.

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[2] In Petitioners' view *Wilko* should be interpreted as a case where this Court *harmonized* two federal statutes. While recent cases have apparently repeated the language of *Wilko*, the fact is that this Court has subtly surrounded such *Wilko* language with a confrontational gloss that casts those resisting arbitration of federal statutory claims in roles of assailants rather than what Petitioners would suggest ought to be roles as beneficiaries of those post-1924 legislative enactments provided for anticipatorily by the 68th Congress when it adopted, in § 2 of the FAA, its savings clause phrase "save upon such grounds as exist at law or in equity . . . " 9 U.S.C. § 2 (1982). The recent confrontational gloss is evidenced by the use of words such as "overriden" (*McMahon*, 107 S. Ct. at 2337) and "exception" (*McMahon* id. at 2338). It is to be noted that the

2. Since *Wilko*'s Analytical Process Has Been Left Intact, Respondent Must Show That The *Wilko* Court Utilized The Process In Such A Manner As Produced An Incorrect View Of Legislative Intent.

McMahon asserts that the *investor* "must demonstrate that Congress intended to make an exception to the Arbitration Act," *McMahon*, 107 S. Ct. at 2338. This alleged burden in the context of the 1933 Securities Act where the strongest possible pro-investor legislative intent was expressed by Congress, is inappropriate. The 73rd Congress rode the crest of a tidal wave of national anger,[3] it was a Congress committed to guaranteeing that the nation would never again be brought to its knees by the corrupt practices of the securities industry. It is critical to recall that the value of securities had fallen by some $50,000,000,000, that so many men's lives had been ruined, that millions of workers had become unemployed, and that capital formation had been drastically reduced. Times were desperate. The legislative response

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Wilko majority utilized the phrase "not easily reconcilable," *Wilko*, 346 U.S. at 438. The choice of "easily" cannot have been fortuitous and suggests that the *Wilko* court did, in fact, reconcile the two acts. Such reconciliation can be achieved by giving the logical interpretation to § 2 of the FAA, namely that if a federal statute such as the 1933 Securities Act makes an arbitration "provision' or "contract," "unenforceable," then it is just that. Rather than there being a frontal assault on the FAA, there is instead the integration of later federal legislative policies *anticipated* by those who drafted § 2 of the FAA. As noted in *Morton v. Mancari*, 417 U.S. 535, 551 (1974), "when two statutes are capable of co-existence, it is the duty of the courts . . . to regard each as effective."

[3] "Out of its despair and anger grew the tenth positive plank of the Democratic National Platform and thereafter the Securities Act of 1933," L. James, *The Securities Act of 1933*, 32 MICH. L. REV. 624, 630 (1934).

was unprecedented. From the enactment of fiduciary[4] standards to the revolutionary adoption of *Caveat Venditor*, the 1933 Securities Act seethed with the highest level of public protection. The legislative history, the text of the Act, contemporary periodical literature, and fifty years of scholarly analysis all vehemently recognize such protective intent. Given the historical context of the 1933 Act one is hard-pressed to imagine that the 73rd Congress *contemplated*, let alone would have ever *approved*, any compromise of investor protection including waiver of § 22(a)'s judicial forum elections – part of what several commentators have called the *in terrorem* civil liability provisions of the Act.[5]

Senate Report 41 berates "high-powered salesmen" and expresses the hope that " . . . this act will provide like advantage and protection for the American investing public and if anyone hereafter shall have the temerity to engage in such nefarious practices as in the past some American security sellers have indulged in, that punishment under this act will be swift and certain. Justice demands that the protection which this legislation will afford to the American people should no longer be delayed." Sen. Rep. No. 41, 73d Cong., 1st Sess. p. 1-2 (1933).

Senate Report 47 further states that one of the legislative goals is "to prevent further exploitation of the public" and " . . . to restore the confidence of the prospective investor . . . " Sen. Rep. No. 47, 73d Cong., 1st Sess. p. 1 (1933). House Report 85 refers to the "cold figures" which "spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years

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[4] "To impose a lesser responsibility would nullify the purposes of this legislation." H.R. Rep. No. 85, 73rd Cong., 1st Sess., 10 (1933) Congress was not of a compromising frame of mind.

[5] See W. O. Douglas & G. E. Bates, *The Federal Securities Act of 1933*, 43 YALE L. J. 171, 173 (1933). The authors also note that "In any event it [Act] will require judicial construction to determine damages . . . " [under § 11]. Id. at 178.

of effort, in these worthless securities" and notes that " . . . persons . . . who sponsor the investment of other people's money should be held up to the high standards of trusteeship." H. R. Rep. No. 85, 73d Cong., 1st Sess. p. 3 (1933).

This report goes on to observe that "The character of civil liabilities imposed by this bill are described in detail elsewhere. Their essential characteristic consists of a requirement that all those responsible upon which the public is solicited to invest money shall be held to standards like those imposed by law upon a fiduciary."[6] Id. at 5. The report continues on to state that "Sections 11 and 12 create and define the civil liabilities . . . Fundamentally, these sections *entitle* [emphasis supplied] the buyer of securities . . . to sue for recovery . . . " Id. at 9.

Nor is the record of the debates of both Houses any less pointed. Representative Mapes noted that the United States was "farther behind than any other civilized nation . . . with respect to preserving the rights of the purchasers of securities." 72 Cong. Rec. 2912 (1933).[7] Representative Sabath noted that the securities fraud problem has " . . . closed thousands of banks, that has

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[6] See also H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933) at 21, § 11(a), and id. at 23 § 12.

[7] The 1933 Act drew heavily on the English experience. As Senator Norbeck noted, for example, that the Act prohibited half-truths, an idea "in fact copied after the British law" 72 Cong. Rec. 3223 (1933). There were also other lessons learned from English law which were particularly relevant to § 14. As noted by one writer, "In England before the Companies Act of 1900 the courts honored stipulations that bound the purchasers to waive the statutory liabilities so long as the stipulations were not too 'tricky' [citing *Greenwood v. Leather Shod Wheel Co.*, [1900], 1 Ch. 421 (C.A.) and *Cackett v. Keswick*, [1902], 2 Ch. 456 (C.A.)]. Since the turn of the century, however, this ready means of evasion has been unavailable in England, and here again Congress profited from the English experience." [footnote omitted] L. Loss, *Fundamentals of Securities Regulation*, 1189 (1983). Professor Loss used *Wilko* as the basis for the Model Securities Code's § 1725 pre-dispute arbitration waiver prohibitions.

forced thousands of small merchants into bankruptcy, and that has thrown 15,000,000 people out of employment" [Applause]. Id. at 2915.

In the words of the bill's architect, Representative Rayburn:

> "This catastrophe so colossal as to stagger the imagination did not come upon our people through the machinations of the common fraud. This loss of an amount equa' to perhaps a third of the total national wealth did not follow from the kind of confidence game against which parents warn their sons. It came through the leadership that the average investor had a right to believe he could trust. These securities were peddled among the people by firms like Halsey, Stuart & Co. . . ."

72 Cong. Rec. 2918 (1933).

Representative Chapman stated "Such criminals ought to be held not only to *full* [emphasis supplied] civil responsibility . . . ", and "If there had been such a law, thousands of widows and orphans would not this day be saddened and crushed as the result of having invested their money in worthless securities . . . The enactment of this bill into law will mean the fulfillment of one of the most vital pre-election promises of our great President and will be another forward step in ushering in a brighter and better day for American business and the American public" [Applause]. Id. at 2935.

Representative Cannon of Wisconsin observed " . . . I do not think there is a Member of this House who has come in contact with more unfortunate victims of fraudulent securities . . . than I. I have seen men and women, old and bent with age, suffer the loss of their life savings as the result of purchasing fraudulent worthless stocks . . . " Id. at 2941.

Representative Lambeth referred to "house to house solicitation that the unwary, the unworldly, and the uninformed are chiefly defrauded. We are all familiar with the high-pressure security salesman, his elaborate technique

of approach and of closing, his prepared harangue to outtalk the unprepared prospect, and his faked-up enthusiasm." Id. at 2949.

Representative Reilly stated that "The real test of the efficacy of this legislative proposal is to be determined by the relentless vigor with which it proposes that the defrauded purchaser may pursue properly responsible parties."[8] Id. at 2952.

Representative Beedy, in reference to prospectus format, noted that the bill would compel the publishing of prospectuses "in sizable type, and not print in some inconspicuous place and in small type statements equally material." Id. at 2953.

In the Senate the story was the same. Senator Fletcher stated: "The purpose of the bill is to protect the investing public . . . to prevent further exploitation of the public . . . to restore the confidence of the prospective investor." Id. at 2983. Senator Johnson echoed House sentiment that investors were vulnerable to " . . . high-powered salesmanship." Id. at 2988.

In summary, the entire legislative history of the 1933 Act clearly shows that Congress accepted the Brandeis thesis of fiduciary obligation, recognized the need to restore investor confidence, pointedly and repeatedly referred to the need to protect the old and unsophisticated, commented on high-pressure sales realities and assailed the "fine print" tactics of the industry. The word "sue" punctuates the entire legislative history.

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[8] And as Dean Landis, who was instrumental in preparing the legislation stated, "We were particularly anxious through the imposition of adequate civil penalties to assure the performance by corporate directors and officers of their fiduciary obligations . . . " J. Landis, *The Legislative History of the Securities Act of 1953*, 28 GEO. WASH. L.REV. 29, 35 (1959/60).

3. Any Re-examination Of The FAA Will Reveal That Such Statute's Goals Were Less Ambitious Than Recent Court Decisions Suggest And Were Perceived To Be Of Less National Significance Than Those Of The 1933 Action.

The legislative history of the United States Arbitration Act, 9 U.S.C. § 1 et. seq. (1982), is rather less instructive as to its goals.[9] Perhaps the most telling comment came in the Senate where Senator Walsh acknowledged that "The business interests of the country find so much delay attending the trial of lawsuits in courts that there is a very general demand for a revision of the law in this regard." 66 Cong. Rec. 984 (1924). Further, the apparent level of comprehension of the literal text of such legislative proposal (at least viewed from the perspective of 64 years of judicial construction) is shown by the Senator's later explanation that the bill meant " . . . that whenever parties agree in their contracts to submit controversies arising under the contracts to arbitration, and then either one refuses to carry out that agreement by appointing an arbitrator, as is provided in the provision for arbitration, the other party may institute his suit in court and recite the facts in relation to the agreement and the refusal upon the part of the other party to appoint an arbitrator- . . . whereupon the court will appoint an arbitrator and the arbitration will proceed."[10] Id. at 984.

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[9] In *Southland Corp. v. Keating*, 465 U.S. 1, 25 (1984), Justice O'Connor asserted that "One rarely finds a legislative history as unambiguous as the FAA's." On the other hand the majority in that same case acknowledged that " . . . the legislative history is not without ambiguities." Id. at 12.

[10] Such an explanation is more in line with the commercial arbitration practices of that era. Those practices were very different from the nature of arbitration of customer fraud claims under the facts presented in Petitioners' cases. What Senator Walsh does unquestionably accurately reveal is that it was *business interests*, not consumers, who were behind the 1924 FAA.

The House Report of the Federal Arbitration Act consists of some 71 lines of text and evidences no intent to do anything but place arbitration agreements "upon the same footing as other contracts . . . " H. Rep. 96, 68th Cong., 1st Sess. at 1 (1924). The report notes that there was an " . . . entire lack of opposition before the committee . . . " Id. at 2.

The Senate Report, Sen. Rep. No. 536, 68th Cong. 1st Sess. (1924), is somewhat longer than its House counterpart,[11] but while it attempts a brief explanation of each of the bill's provisions, no attempt is made to explain § 2 which is surely one of the most significant and enigmatic phrases in the act, namely " . . . save upon such grounds as exist at law or equity for the revocation of any contract." 9 U.S.C. § 2 (1982). The Senate Report, id. at 3, additionally reveals that the Arbitration Society of America was involved in the bill's passage.[12] There is nothing in the Senate Report which suggests any kind of an *elevated* federal policy.[13]

In reality the Federal Arbitration Act duplicated the key provisions of the New York Arbitration Act which

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[11] There was essentially no debate in either House.

[12] The Act was also endorsed by the American Bar Association, although the FAA provisions conflicted with the ABA's Commission on Uniform Legislation endorsement of only *existing* dispute enforceability (as per the Uniform Act). See S. Jones, *Historical Development of Commercial Arbitration in the United States*, 12 MINN. L. REV. 240, 249, n. 45 (1928).

[13] "Some courts, to be sure, have discerned 'a strong federal policy in favor of [commercial] arbitration' over litigation. This policy they say, arises to 'help ease the current congestion of court calendars.' But the authorities relied upon by these courts reveal no such policy." [footnotes omitted] Notes, *Incorporation of State Law Under the Federal Arbitration Act*, 78 MICH. L. REV. 1391, 1403 (1980). In truth the "same-footing" catchphrase suggests something very different from an "elevated policy."

had been passed five years beforehand.[14] Recognizing that consumerism was in its infancy and that the spirit of laissez faire was not finally exorcised until the demise of substantive due process, it is fair to surmise that what Congress had in mind in 1924 was the validation of the enforceability of the historically familiar fields of commercial arbitration, insurance, maritime, and multinational,[15] with no intent to burden future federal policies expressed in legislative form.[16]

Considering the text and legislative history of both the Federal Arbitration Act and the 1933 Securities Act, it is difficult to fairly view Congressional intent in any fashion but as precluding the enforcement of pre-dispute, public customer[17] form contracts with arbitration terms buried in the fine print. As shown, the legislative history of the 1933 Act addresses in some fashion, each such parameter.

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[14] See, for example, T. Stipanowich, *Rethinking American Arbitration*, 63 IND. L.J. 425, 426 n. 2 (1988) "Extensive lobbying efforts secured . . . legislation modeled on New York's act."

[15] See H. Cohen & K. Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265 at 265 (1926). ". . . the reform is directed primarily toward settlement of commercial disputes." The authors further noted that "Not all questions arising out of contracts ought to be arbitrated. It is a remedy peculiarly suited to the disposition of the ordinary disputes between merchants as to questions of facts – quantity, quality, time of delivery . . . It is not the proper method for deciding points of law of major importance involving constitutional questions or policy in the application of statutes . . . " Id. at 281.

[16] Nor to critically damage state consumer protection law which is the practical result of the interpreted breadth of the Commerce Clause.

[17] Especially the unsophisticated investor. Generally, see C. Fletcher, *Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements*, 71 MINN L. REV. 393 at 427 (1987) "THE SOPHISTICATED INVESTOR EXCEPTION – ITS TIME HAS COME."

4. Post-enactment Conduct Demonstrates The Congressional View Of The Preeminence Of The 1933 Act.

Again, as noted elsewhere, in 1975 Congress specifically endorsed *Wilko* and its non-arbitrability *ratio*.[18] While Petitioners are not persuaded by the majority's opinion in *McMahon* that the legislative reference in question was not an endorsement of the non-arbitrability of § 10(b) claims under the 1934 Exchange Act, 107 S. Ct. at 2343, that worst-case Exchange Act hypothesis cannot be transformed into a legislative disapproval of *Wilko* per se.[19]

To all of the above must be added the observation that Congress has been in the process of legislatively addressing *McMahon* and the fact that no parallel legislative proposals have yet been suggested with respect to

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[18] As this Court noted in *Herman & MacLean v. Huddleston*, 459 U.S. 375, 384-5 (1983), "This cumulative construction of the remedies under the 1933 and 1934 Acts is also supported by the fact that, when Congress comprehensively revised the securities law in 1975, a consistent line of judicial decisions had permitted plaintiffs to sue under § 10(b) regardless of the availability of express remedies. In 1975 Congress enacted the 'most substantial and significant revision of this country's Federal securities *laws* [emphasis supplied] since the passage of the Securities Exchange Act in 1934.' See Securities Acts Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 . . . In light of this well-established judicial interpretation to leave § 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action."

[19] Petitioners note here that while the *Wilko* comment was made in the context of amendments to the 1934 Exchange Act, certainly had Congress any desire to legislatively disagree with *Wilko*, it would have been a relatively simple matter to include an appropriate amendment to the 1933 Act. One will recall that amendments to the 1933 Act were contained in the 1934 legislation itself in Title II.

the *1933 Act* carries with it the inference that *Wilko* is still viewed by Congress as having been correctly decided.[20]

As a matter of clear legislative intent, therefore, § 12(2) claims may not be subjected to compulsory arbitration.

III. THE QUALITY OF ARBITRATION IS NOT RELEVANT TO *WILKO* BECAUSE THE 1933 ACT'S GOALS ARE INCONSISTENT WITH ALL PRE-DISPUTE COMPULSORY ARBITRATION AGREEMENTS

1. Any Focus On The Quality Of Arbitration Is Inappropriate With Respect To The 1933 Act.

Given the observable recent pro-arbitration stance of this Court, which can most clearly be seen beginning with *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974), it is difficult not to view *McMahon*, as many commentators already have, as the staging ground for an assault on *Wilko*.[21] The legitimacy of such assault is jurisprudentially as well as politically questionable.[22]

As Petitioners have argued elsewhere, *Wilko* clearly held that arbitration was *inherently* antithetical to the

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[20] Although H.R. 4960 died last year, it is likely to be reintroduced.

[21] See, Note, *The Arbitrability of Federal Securities Claims: Wilko's Swan Song*, 42 U. MIAMI L. REV. 203, 228 (1987).

[22] Petitioners believe that *McMahon* was wrongly decided and that, but for those principles of stare decisis set forth by Petitioners elsewhere in support of the preservation of the *Wilko* precedent, they would otherwise advocate that *McMahon* be overruled. The only arguably credible justification for the *McMahon* opinion, in Petitioners' view, is that the Exchange Act lacked the multiple forums found in the 1933 Act as many commentators have noted. According to one, "[In *Wilko*] The Supreme Court emphasized that SA § 22(a) (conferring jurisdiction over suits to the courts) could not be waived because it gave the aggrieved person the right to select the judicial forum." See A. Bromberg & L. Lowenfels, 2 *Securities Fraud and Commodities Fraud*, § 5:128 (1988).

legislative mandate of the 1933 Securities Act. That reality, variously verbalized by legal commentators and courts over the past thirty-five years, was, as noted, also utilized by this Court in distinguishing *Wilko* in all of the relevant cases preceding *McMahon* and no matter how skillful an attack is launched from the haze[23] of *McMahon*, *Wilko* cannot, in logical terms, be circumvented without significant institutional loss.

No matter how desirable a destruction of *Wilko* may appear from the perspective of a reduction of the federal docket,[24] the word "arbitration" in *Wilko* should not be

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[23] "The Court was intentionally sending a mixed signal, so that its discussion of *Wilko* would not be misunderstood as a decision on a matter not squarely before the Court. That mixed signal indicates that although the Court was willing to disparage *Wilko* as without foundation under contemporary circumstances, it was unwilling to give a hint as to how it might decode that case . . . today." C. Fletcher, *Learning to Live With the Federal Arbitration Act - Securities Litigation on a Post-McMahon World*, 37 EMORY L.J. 99, 114 (1988).

[24] One writer has observed, "As we reflect, above all we must remember that the overarching goal of alternative dispute resolution is to provide equal justice for all." 'If . . . reform benefits only judges, then it isn't worth pursuing . . . ' H. Edwards, *Alternative Dispute Resolution: Panacea or Anathema?*, 99 HARV. L. REV. 668, 684 (1986) (Citing Higginbotham, *The Priority of Human Rights in Court Reform*). Another commentator has noted that "Given repeated assertions regarding the near crisis state of the overloaded judicial system, one might think that the intent behind the Arbitration Act was to override judicial enforcement of all legal claims except those whose removal from the courts might prompt an even more immediate crisis in the country's institutional structure." E. Morgan, *Contract Theory and the Sources of Rights: An Approach to the Arbitrability Question*, 60 S. CAL. L. REV. 1059, 1068-9 (1987).

given a 1989 footnote explaining that the contemporaneous *quality* of arbitration was really the fatal flaw detected in *Wilko*. It was not.[25]

It is to be further observed that a good argument can be made that the *Wilko* court would, on the facts now before this Court, have voted *unanimously* to declare these Petitioners' claims non-arbitrable in the context of this pre-dispute form contract. That argument can be made because the two *Wilko* dissenters specifically stated that their view of arbitrability would be different if Plaintiff "in opening an account had no choice but to accept the arbitration stipulation, thereby making the stipulation an unconscionable and unenforceable provision . . ."[26] 346 U.S. at 440.

While it would otherwise be appropriate to argue here that § 10(b) claims are distinguishable from § 12(2) claims (and that therefore whatever *McMahon*[27] held that it is not a holding that conflicts with *Wilko*), that argument in effect has already been presented most skillfully

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[25] The *McMahon* majority opinion fails to effectively address the problem of the variable quality of arbitration. While there is some suggestion in *McMahon* that perhaps arbitration of § 10(b) claims is acceptable so long as that arbitration is subject to the scrutiny of the SEC, the irony is that investors would be, on the evidence thus far presented by the AAA and SIA, apparently statistically better off in an AAA proceeding.

[26] Lack of choice is now the case with *this* type of account. See *infra* at 46 n. 98.

[27] The following are some of the critical scholarly comments relevant to the view of arbitrability of 10(b) claims and/or of *McMahon* per se: "A careful reading of *Wilko*, coupled with a thorough analysis of the relevant provisions of the two securities acts, requires that the *Wilko* doctrine be extended to section 10(b) claims.", Comments, *Predispute Arbitration Agreements Between Brokers and Investors; The Extension of Wilko to § 10(b) Claims*, 46 MD. L. REV. 339, 377 (1987); "What is more difficult

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to understand is why in *Shearson/American Express v. McMahon*, the Court held that predispute arbitration clauses should be enforceable in spite of statutory mandates and the ramifications of the decision . . . Since 1982 there have been at least 10 million new investors . . . and a 128% increase in complaints against brokers filed with the SEC, a total of 15,750 complaints in 1986. The market crash of October 19, 1987 spawned scores of disputes . . . Thus the mandatory enforcement of predispute arbitration agreements will have a significant impact on investors' efforts to recover . . . " [footnotes omitted], P. Shub, *Shearson/American Express v. McMahon: The Expanding Scope of Securities Arbitration*, 12 NOVA L. REV. 1375, 1378-9 (1988); "In response to the Supreme Court's recent endorsement of the arbitral process, Congress must now take measures to assure that, in the steady move towards arbitrability investors' rights are not being unduly compromised." Notes and Comments, *Enforceability of Predispute Arbitration Agreements Under the Federal Securities Laws: Shearson/American Express vs. McMahon*, 8 PACE L. REV. 193, 235 (1988); "The problem with the *McMahon* opinion is the Court's misreading of the *Wilko* decision.", Note, *Securities-Arbitration-Agreements to Arbitrate Are Valid*, 10 U. ARK. LITTLE ROCK L.J. 523, 532 (1987-88); "Rather than following these cases [*Byrd*, and *Mitsubishi*] the Supreme Court should re-examine its still valid reasoning in *Wilko*.", H. Sanchez, *Should Claims Involving Public Customers Arising Under the Securities Exchange Act of 1934 Be Subject to Compulsory Arbitration?*, 10 HARV. J. LAW & PUB. POLICY 173, 187 (1986); "The note concludes that the *McMahon* Court reached the wrong result by giving an unprecedented interpretation to the Exchange Act, by reading *Wilko* too narrowly, and by ignoring policy problems inherent in the arbitration of securities disputes.", Note, *Who's Protecting the Investors? Shearson/American Express v. McMahon*, 19 ARIZ L. J. 793, 794 (1987) (The Note also observes that " . . . the concerns about the suitability of arbitration apply with perhaps greater force today than in 1953 when *Wilko* was decided." Id. at 812); " . . . *McMahon* . . . held that brokerage houses may include arbitration provisions within client agreements. Unfortunately the *McMahon* Court simply condoned section 10(b) arbitration without considering

by Respondent to this Court[28] and to the Fifth Circuit[29] where Respondent argued that *Wilko* was clearly distinguishable because of 1933/1934 Act differences. Hopefully this Court, will not be swayed by what Petitioners now anticipate will be a change of heart by Respondent.

2. A Basic Analysis Of The Circumstances Surrounding These Petitioners' Cases, Shows That Compulsory Arbitration of Petitioners' Claims Is Antithetical To The Undisputed Goals Of The 1933 Act.

A. First Level Arbitration Analysis

Notwithstanding those insightful admonitions frequently made concerning the limitations of common sense, Petitioners believe that certain common sense, general observations should be made about arbitration of Petitioners' claims under the 1933 Act.

First, the very fact that the specific arbitration language appears in a form document prepared by industry lawyers, at least *suggests* that Respondent put the arbitration term in such form document for some purpose that was deemed by Respondent to be beneficial to Respondent. Respondent's posture is, of course, that the reason for the utilization of the clause is that arbitration saves time and money. The further argument is then advanced that such benefits are mutual and hence fair. Before examining the substance of such argument, it is useful to look first at the specific document context in which the

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the possible repercussions of its *en mass* implementation.", comments, *A Statutory Proposal to Determine Arbitral Forums For 10(b) Disputes*, 28 SANTA CLARA L. REV. 389, 415-16 (1988).

[28] Brief of Petitioners, *Shearson/American Express v. McMahon*, No. 86-44, at 16-32.

[29] "Claims under the Securities Exchange Act of 1934 are arbitrable, whereas those under the Securities Act of 1933 are not, precisely due to the differences in those Acts . . . " Reply Brief of Appellant Shearson/American Express, *Mayaja v. Bodkin*, No. 85-2762 (5th Cir. 1985) p. 4.

arbitration term was found. This particular arbitration clause was buried in fine print, in the last paragraph of the first side of a two-sided document. The particular paragraph[30] not only begins with an obscure reference to "successors," it is also preceded by a dozen other fine-print paragraphs which would challenge the intellect and attention span of the proverbial Philadelphia lawyer.

Further, this particular arbitration paragraph contains an *election-of-law* provision so that the investor has apparently agreed that Texas law will not apply. Not only may that be perceived as objectionable per se, it is all the more so when one observes that in order to do business in Texas (as is true in most states), brokers are compelled by their Uniform Securities and Commodities Applications to promise, in writing, to the Texas Securities Commission, to abide by all the laws of Texas.

The sworn verification portion of that U4 application, for example, reads as follows:

> "2. To induce the agency, *jurisdiction* or organization with or to which I am filing or submitting this application to receive and consider it:
>
> C. I agree to abide by the *Statute(s)*, Constitution(s), Rules and By-Laws as *any* of the foregoing are amended from time to time of the agency, *jurisdiction* or organization with or to which I am filing or submitting this application." [emphasis supplied]

Further, and even more specifically, Paragraph 5 of the U4 verification provides as follows:

> "5 . . . *and I do hereby consent that any such action or proceeding against me may be commenced in any court*

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[30] The paragraph read as follows: "This agreement shall inure to the benefit of your successors and assigns, shall be binding on the undersigned, my heirs, executors, administrators and assigns, and shall be governed by the laws of the State of New York. Unless unenforceable due to federal or state law, . . . "

of competent jurisdiction and proper venue within said State . . . "[31] [emphasis supplied]

Notwithstanding the above, Respondent's arbitration paragraph not only attempted to limit the arbitration forum to the NYSE and NASD (a limitation which should also be perceived as per se objectionable) this form paragraph also required that the customer elect between the pre-chosen two forums *within five days*. That period of time is unconscionably short.[32]

The next common-sense observation to be made is that regardless of whatever level of supervision of the Securities & Exchange Commission is imposed,[33] the customer has, in effect, agreed to have his case brought

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[31] It is to be noted that this paragraph refers to *any* action in *any* court.

[32] Since the investor, regardless of his level of sophistication, is unlikely to have been previously involved in any type of arbitration proceeding, it is obvious that he will have no information upon which to make such an election but would surely sense that such an election is important and would surely believe that a five day deadline is unfair. That period of time is, for example, 15 days less than time allowed for answering a federal court complaint. While the focus here is the *perception* of this time-constraint, Petitioners would also be very interested in viewing this Respondent's 1988 case files to see 1) how many times has Shearson/American Express been able to itself make the forum election because the five-day deadline was not met by the investor, and 2) when Respondent makes such default elections, whether or not such elections have been divided evenly between the NASD and NYSE. Petitioners suspect first that it is in fact Respondent who makes the majority of forum elections, and second that as an indication of Respondent's knowledge or belief that one or the other forum is most advantageous to this Respondent, that such case files would reveal that Respondent chooses particular forums in particular parts of the country.

[33] Which in Petitioners' view has never been very significant as the non-enforcement of Rule 15c2-2 has shown. See also, Ingersoll, *Sleepy Watchdogs*, WALL ST. J., July 21, 1987 at 1, col. 6.

before a division the brokerage house's peers.[34] Given the obvious inequality in power between Respondent and any of these investors, it is not unreasonable to assume that such investor would be at a significant disadvantage *in any forum*, however, winning contests on the opponent's home court is difficult even where combatants are evenly matched.

Third, the direct inherent economic self-interest of the forums themselves must be recognized. Officials of the arbitration divisions of the NYSE and NASD have dependents to support. So do the arbitrators themselves. Without arbitration, there is no employment. Why do the NYSE and NASD get to decide public customer securities fraud cases? Is it because the *investor* has selected both as options? Hardly. The NYSE and NASD hear these cases *because it is brokerage houses like Shearson/American Express who select such entities as arbitration forums by printing those forums' names in the form document* in the first place. Can it be seriously doubted what would happen if these "unbiased" arbitration proceedings produced frequent and large awards against the party that gets to specify what arbitration forums can be utilized? It is for that very reason that such arbitration, as presented in this type of securities fraud case, is *intrinsically and irreparably* unfair to investors. That unfairness is even further amplified when this financial self-interest is solidified by the arbitration forum as an *official* policy carried out through the exchange's manipulation of the composition of arbitration panels as is now the case.

Beyond these most obvious, inherent common-sense realities lurk a plethora of serious constitutional law issues. While it is true that most constitutional objections have already been individually dispatched,[35] the sheer

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[34] As noted by one commentator, "SRO's are funded by and most closely involved with their members." S. Miller, *Self-Regulation of the Securities Markets: A Critical Examination*, 42 WASH. & LEE. L. REV. 883, 884 (1985).

[35] See, for example, *Thomas v. Union Carbide Agricultural Products Co., et al*, 473 U.S. 568 (1985) with respect to Art. III issues.

number and weight of all of these constitutional issues is deeply troubling. Taken together, the issues of Article III judges,[36] waiver of jury,[37] due process and pre-emption of state law, are truly disturbing.[38]

Further, if arbitration is such an outstanding, *mutually* advantageous forum choice, why does the securities industry need to have *pre*-dispute arbitration terms? Surely if there is a mutuality of advantage the market will, via *post*-dispute agreements negotiated by the parties, make such *pre*-dispute agreements unnecessary. Presumably even the most skeptical, misguided litigant or attorney will eventually see the light. The simple truth, however, is that Respondent and the Securities Industry see enormous *unilateral* advantage in *this* form of arbitration, much of which would be lost by a *bargained-for* arbitration format where defrauded customers could negotiate rules, remedies, and arbitration personnel.[39]

Accordingly, whatever the alleged level of mutuality or quality of arbitration, a common sense, thoughtful

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[36] The framers considered it critically important that federal judges be given the highest level of independence. The nature of fraud relevant to these Petitioners gives cause for concern that *all* of that level of decisional independence is required for these Petitioners.

[37] Would it not be reasonable, for example, to require at least a knowing/intelligent waiver of the right to a jury trial? See, for example, *Hodges v. Easton*, 106 U.S. 408, 412 (1882) " . . . every reasonable presumption should be indulged against its [jury] waiver." Petitioners would suggest that in the overall scheme of things, that the Seventh Amendment is deserving of a better fate than effective repeal by an ill-considered 1924 enactment interpreted in such a fashion as to raise public concern as to judicial motive.

[38] They suggest an argument for an arithmetic constitutional rights violation theory somewhat in the reverse nature of principles seen in one-man/one-vote multi-districting doctrinology.

[39] Perhaps a fairly bargained-for arbitration *was* the intent of the FAA. See Senator Walsh's FAA comments, *supra* p. 12.

review of these relevant customer contracts would surely and reasonably create at least the strongest *suspicion* that there is a significant unilateral benefit to the brokerage-house. That suspicion is not diminished by the further realization that the brokerage house will rarely be a *plaintiff* in a customer dispute.

In *any* context, all of the above considerations would indeed be weighty, but in the context of the fiduciary standard[40] imposed by the 1933 Act upon those entrusted with "other people's money,"[41] that such pre-dispute arbitration clauses are given *any* legitimacy, is somewhat remarkable.[42] Perhaps the greatest of life's tragedies is that ultimately we profit so little from the lessons of history.

All of the above first-level investor perceptions clearly constitute a conflict with the patent, oft-repeated goal of the 1933 Act *to create confidence in the stock market*

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[40] Aside from the unenforceability intent issues of the 1933 Act, it is to be noted that § 173, *Restatement (Second) Of Contracts*, (1982) would render certain contracts with fiduciaries voidable. Those fiduciary principles are germane here.

[41] "There was a restatement of the earlier creed of Brandeis that members of the financial oligarchy handling other people's money are trustees." W. O. Douglas, *Foreward, The Legislative History of the Securities Act*, 28 GEO. WASH. L. REV. 1, at 1 (1959). See also, H. Rep. 85, 73d Cong., 1st Sess. at p. 3 (" . . . should be held up to the high standards of trusteeship."); ("The character of civil liabilities imposed by this bill . . . consists of a requirement that all those responsible for statements upon the face of which the public is solicited to invest . . . shall be held to standards like those imposed by law upon a fiduciary."). id at 5.

[42] States like Massachusetts have also recently attempted to respond to *McMahon* (see 950 CMR 12.204 (a)(2)(G) (1988)), however pre-emption is probably an insurmountable impediment in light of *Keating*.

so as to revitalize capital formation,[43] and cannot be negated by any improvement of arbitration per se since these first level problems are, more than anything, problems of *context*.

B. Second Level Arbitration Analysis

The second level of Petitioners' arbitration analysis focuses on the intent[44] of Respondent as is logically deducible from a less-easily perceived arbitration attribute extant at the time these form documents were presented to Petitioners and such attribute's resultant impact on the legislative goals of the 1933 Act.

That Texas residents – or the residents of the other forty-eight states – would be required to agree that the law of *New York* would apply, raises some immediate substantive suspicion.[45] Petitioners limit their analysis here to a single characteristic of arbitration then extant under New York law, namely the unavailability punitive

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[43] "It may be argued that whether or not the arbitration agreement was imposed on an unknowing investor, the investor is just as well off, if not better, in arbitration. Whether or not this is true, the critical consideration in the markets of capital accumulation has always been the public perception of the market. Even if the buyer is just as well off financially in arbitration, if he thinks he was misled in being forced to arbitrate he may lose confidence in the industry and refuse to invest further. This would clearly be detrimental to our economy as a whole." J. D. Fiore, *Problems In Alternative Dispute Resolution: Arbitration Agreements As Contracts of Adhesion in Consumer Securities Disputes*, 93 COM. L. J. 259, 277 (1988).

[44] The fact that these first-time investors, possessing conservative investment objectives, were immediately required to sign a *margin* agreement is an excellent frame of reference from which to begin an analysis of Respondent's probable intent.

[45] As noted by one commentator, the historical choice of law manipulation practiced by the industry was a fundamental evil the 1933 Act sought to eradicate through the creation of federal

damages. At the time the relevant documents were presented to Petitioners, Respondent knew that punitive damages had not been historically awarded in New York arbitration.[46]

If arbitration is indeed a "forum neutral"[47] election then one would expect that there would be a remedial neutrality. That is not the case. One has merely to ask the following question: On how many occasions since the initiation of broker-customer relationships, has a brokerage house recovered *or even sought*, punitive damages either in litigation or arbitration as against a public customer?

Accordingly, this second level analysis reveals a serious conflict with the both primary goals of the 1933

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substantive law. See G. Feldman, *The New Federal Securities Act*, 14 B.U.L. REV. 1, 2 (1934), "clauses providing that the contract was to take effect 'only upon acceptance at our home office,' fell neatly within the categories of conflict of laws doctrine . . . And the courts have been reluctant to depart from established doctrine even in cases where it had obviously been used merely as a subterfuge to avoid the securities legislation of the investor's residence . . . The call for a remedy for this situation became more pressing with the sharpened insight resulting from a badly shaken securities market. A new administration brought an immediate response to the public clamor. That response was the new Federal Securities Act." [footnote omitted]

[46] *Garrity v. Lyle Stuart, Inc.*, 40 N.Y. 2d 354, 386 N.Y.S. 2d 831, 353 N.E. 2d 793 (N.Y. 1976). Despite the frequent statements of subsequent supervision of securities arbitration proceedings by courts, the conventional jurisprudence surrounding the FAA, the overwhelming weight of scholarly analysis, give little cause for optimism.

[47] The entire substance/procedure premise in *McMahon* is difficult to square with *Bernhardt v. Polygraphic Co.*, 350 U.S. 198, 203 (1956) where the Court wrote that " . . . the remedy by arbitration . . . substantially affects the cause of action . . . "

Act – the unprecedented *substantive* protection of the investor *and* the restoration of investor confidence in the market. The extant quality of arbitration alleged does not negate these second-level conflicts with the 1933 Act's goals, nor would any later alleged improvement retroactively cure an investor's perception that an attempt had been made to take advantage of such investor originally.

C. Third Level Arbitration Analysis

Petitioners' third level analysis focuses on Respondent's representation that arbitration is procedurally less expensive and less time-consuming (insofar as those representations are relevant to Petitioners' securities complaints).

The expense of processing civil complaints has three major components – administrative fees, attorneys fees, and witness costs. Since Petitioners, if successful in litigation, would likely recover attorneys fees under as many as four independent state law theories, what is immediately known is that arbitration is likely to make securities complaints less expensive *for the brokerage house* since attorney's fees have not traditionally been awarded in arbitration. The brokerage house will be relieved of paying all *Plaintiffs'* attorneys fees.[48] Even if industry contracts contained a provision that *prevailing* parties in a securities dispute would be awarded attorneys fees, and even *if* one accepts uncritically those arbitration statistics

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[48] See Art. 75, CPLR (Arbitration) § 7513 (N.Y.) for Petitioners' election concerning attorneys fees. With respect to attorney's fees, the following question would surely also be relevant: Why are attorneys fees historically awarded to successful commercial litigation plaintiffs and why has virtually every modern consumer protection statute provided attorneys fees for prevailing consumers? As one writer has noted, "Before UDAP [consumer deceptive trade practices statutes] were enacted, consumers with meritorious complaints were often discouraged from bringing actions because their potential recovery might not justify the cost of litigation. Many UDAL statutes

presented in the Brief of the Securities Industry Association in Support of Certiorari herein,[49] the most recent (1987) data appears to reveal that more than 50%[50] of public customers recovered awards. Accordingly, by omission of an attorneys fee provision in the form contract, and by the otherwise non-availability of attorneys fees in arbitration, the industry's own figures suggest a net economic benefit to industry members.

Since the conventional court system is a subsidized system,[51] it is not surprising to find that usual court

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addressed this problem by providing attorneys fees, and minimum, multiple or punitive damages. The attorneys fees generally reimburse successful plaintiffs [footnote omitted]. Notes, *Resolving the Conflict Between Arbitration Clauses and Claims Under Unfair and Deceptive Practices Act*, 64 B.U.L. REV. 377, 384-85 (1984). Texas law is typical. Tex. Bus. & Com. Code, § 17.50(d) (The Texas Deceptive Trade Practices Act), and Tex. Civ. Rem. & Prac. Code, (§ 38.001(8)) provide for attorney's fees in most consumer contexts. The answer is, of course, to make it economically feasible for the consumer to have the necessary competent legal representation. Without that legal representation the consumer is hopelessly overmatched. Shearson/American Express will never want for the best available legal representation, nor, if the history of the Brownsville office is at all instructive, will Respondent lack good first-hand experience in handling securities fraud claims.

[49] Amicus Curiae Brief, Securities Industry Association, *Rodriguez v. Shearson/American Express*, No. 88-385, Appendix A.

[50] 635 out of 1,146 cases were supposedly decided "in favor" of the public in relevant self-regulatory organizations. Id. at A-3. The fact is that because of the lack of records in arbitration and because of one-line awards, there is an "information vacuum." Once again investors are being asked to trust the industry. These Petitioners respectfully decline. As noted by Respondents in *McMahon*, AAA and SIA statistics are, in any case, misleading. See Brief of Respondents, *Shearson/American Express v. McMahon*, No. 86-44 at 28, n. 22.

[51] Which in and of itself is a reflection of the perception of justice as a societal responsibility.

administrative costs are not overly significant. For complaints of Petitioners' nature, filing and service costs would not normally exceed $200.00 whereas arbitration filing costs relevant to such complaints would typically be $750.00.[52]

Witness costs[53] relevant to Petitioners' claims demonstrate that arbitration is considerably *more expensive* for Petitioners. For example, Respondent, prior to the original appeal in this case, had filed an arbitration application which was scheduled to be heard in Dallas. Such venue would require that somewhere in the neighborhood of forty of Petitioners' witnesses would be required to travel to Dallas. Such expense cannot be deemed an expense "advantage" to Petitioners who otherwise would litigate in Brownsville where most witnesses live and where the fraud occurred.[54]

With respect to allegations of expenditure of *time*, an immediate distinction must be made between the expenditure of time in the process of resolution (which Petitioners would suggest is an expenditure correlating well with the quality of justice dispensed) as opposed to the

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[52] The NASD/NYSE range for these types of fraud claims is from $500.00 to $750.00. See, for example, Sec. 43, NASD Manual-Code of Arbitration Procedure, reprinted by Commerce Clearing House, Washington, D.C. (1985).

[53] Petitioners would suggest that *expert* witness costs would not be significantly venue-dependent on these particular facts.

[54] Venue is, of course, a problem. For an enlightening discussion of venue and securities fraud, see, Comments: *A Statutory Proposal to Determine Arbitral Forums For 10(b) Disputes*, 28 SANTA CLARA L. REV. 389, 391 (1988). As noted there, ". . . *McMahon* gives brokers the opportunity to take advantage of investors because it fails to address the key issue of venue." For a discussion of "cross-country" arbitration and the consumer, see Notes, *Incorporation of State Law Under the Federal Arbitration Act*, 78 MICH. L. REV. 1391, 1412 (1980).

length of time which is like to pass between the *filing of the complaint and a decision or award*. It is this latter category of time-expense which the securities industry apparently advances as a mutual benefit[55] since the industry statistics are structured to make such an argument by showing a rapid turnover of cases. Since the industry is an industry of institutions, with infinite lives, whereas public customers like Petitioners have finite existences, it seems reasonable to conclude that the time of case turnover would be most relevant to *Petitioners*.

Accordingly Petitioners' third level arbitration analysis suggests that if attorneys fees are not awarded, that Respondent and industry members escape paying attorneys fees normally awarded in commercial litigation to prevailing parties, that it is only investors who lose punitive damages, that arbitration *creates* significant venue costs relative to witnesses, that from Petitioners' viewpoint arbitration has no significant impact on administrative costs, and that arbitration has no discernibly *significant* time advantage.[56] Such third level analysis suggests conflicts with the 1933 Act's overall goals of providing an unprecedented level of investor protection and of safeguarding the national economy

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[55] "Arbitration also offers an expeditious result." Amicus Curiae Brief of the Securities Industry Association in Favor of Certiorari, *Rodriguez v. Shearson/American Express*, No. 88-385, at 12.

[56] If every securities complaint becomes subject to compulsory arbitration, or if arbitration's currently suggested reforms are enacted (to expand, for example, discovery) the complaint turnover rate promises to be significantly depreciated. Nor is there necessarily a direct cost nexus to turnover rate. Those other cases related to Petitioners' cases owing to the Southern District of Texas drug and immigration docket, have been sitting for several years in such court without additional costs accruing.

through stimulation of investor confidence, neither of which goals are aided by existing securities arbitration in an adhesive, fiduciary, pre-dispute format.[57]

D. Fourth Level Arbitration Analysis

Petitioners' fourth level analysis focuses on the quality of arbitral *outcome*, which, as is true with prior level analyses, is not only apparently relevant to this Court's view of arbitration expressed in *McMahon*, but also to the Court's anticipated view of the 1933 Securities Act.

As has been recently observed, there has been in "first-wave" alternative dispute resolution, a proclivity for ignoring larger jurisprudential issues.

> "Specifically, while lauding the *quality of its results*, the First Wave ADR movement appears to desire a reduction of the *quantity* of traditional litigation by "focusing" or restricting dispute solutions to the narrowest and most simple results. In the process, the beneficial "public" impact of dispute resolution may be lost and the guidance function of substantive legal norms may be ignored. Similarly, while ADR presents an innovative shift in the procedure of dispute resolution, few ADR proponents have dug deeply into the process oriented "instrumentalist" jurisprudence represented in the writings of Fuller and others. Surprisingly, few jurisprudence and legal philosophy scholars have joined the debate between the First and Second Wave factions, learning the dialectic

[57] It is instructive to note here that in 1933 Representative Black, after refering to civil remedies in the proposed 1933 Act observed that criminal sanctions had never been historically effective. Black posed the rhetorical question "Why do we need this law? We need this law because of the nonenforcement of all present statutes . . . against larceny." See 72 Cong. Rec. 2953 (1933). The Act's civil provisions which operate via the most reliable of human characteristics, self-interest, are the best hope of effectuation of such legislative goals.

> to scholars of judicial administration and to interested parties who stand to gain from an increased ADR market share." [footnotes omitted][58]

Petitioners believe that recent arbitration decisions of this Court, and the pro-arbitration briefs filed by the securities and arbitration industries, are most accurately viewed as "first wave" ADR theory. That first wave theory would appear to contain a focus inappropriate to federal legislative causes of action generally, but specifically inappropriate to the expressly instrumentalist goal[59] of the 1933 Securities Act which was to restore confidence in the investing public.[60]

Since arbitration is inherently non-instrumentalist, Petitioners would thus question the *relevance* of any alleged original or enhanced arbitration to *Wilko* or to the 1933 Securities Act. Petitioners also do not accept the reality of such enhancement nor do Petitioners believe, in any case, that anyone has *affirmatively established* the existence of such alleged enhancement. Since it is clearly demonstrable that there is no equality in technical, procedural attributes,[61] any argument that arbitration is

[58] E. Brunet, *Questioning the Quality of Alternative Dispute Resolution*, 62 TUL. L. REV. 1, 7-8 (1987).

[59] It is to be noted that but for the newspaper coverage of a related case, it is unlikely that these Petitioners would have ever even discovered that they had claims. The industry has an understandable affection for the effective secrecy of the arbitration process.

[60] See, for example, Sen. Rep. 47, 73d Cong., 1st Sess. p. 1 (1933) "The aim is . . . to restore the confidence of the prospective investor . . . "

[61] The following is a non-exhaustive list of procedural deficits of arbitration vis a vis litigation: Jury trial, Article III judges, discovery tools, choices of forum, injunctive relief, and appeal. It is to be noted in relation to the latter, that under the United Kingdom law of arbitration, arbitration agreements may be reviewed by courts for revocability when there is a fraud complaint in the context of a *pre-dispute* agreement. Arbitration Act of 1950, 14 GEO. 6, C. 27, § 24(2), § 25(2) (U.K.). There is

merely a "forum substitute" must thus be cast in terms of result. The problem for Respondent and for the industry is that such argument has never been substantiated empirically.[62] Empirical proof would require that advocates of arbitration establish that the net result of a given arbitration proceeding, from the public customer's standpoint, is equivalent to that result which would be otherwise available through litigation. That proof cannot be manufactured from current arbitration statistics presented to this Court since no serious attempt has been made to document litigation results. All of such proof elements are patently required to prove that the quality of arbitration has *improved* since *Wilko*. Such proof was not offered in *McMahon*.[63]

Without such clear, convincing, *proof*[64] that the arbitration of fraud claims induced by a self-interested fiduciary via an adhesion contract, not meeting the reasonable expectations of the beneficiary, is totally consistent with the *universally* recognized goals of the 1933

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also potential court review via the Arbitration Act of 1979 (1979-c42 U.K.) for certain types of errors of law, errors which have been traditionally reviewable under English jurisprudence.

[62] In its *McMahon* Amicus Brief, the Securities Industry Association advanced the singularly unconvincing argument that "Any lingering doubt as to the efficiency and fairness of arbitration" was "quelled by the history" of the *Phillips v. Merrill Lynch, Pierce, Fenner & Smith Incorporated* arbitration. See *Brief of Amicus Curiae In Support of Petitioners, Shearson/American Express v. McMahon*, No. 86-44, at 9-10.

[63] Respective empirical data from 1953 would surely also be required to substantiate *improvement*. And, of course, any improvement would not be relevant, in any case, to the *Wilko* Court's determination that arbitration is *inherently* impermissible under the 1933 Securities Act.

[64] Such proof is required *not* because of some undisclosed residual judicial distrust of arbitration but rather by adherence to those legal principles requiring that the intent of Congress be imposed upon all.

Securities Act this Court must endorse *Wilko* even upon the erroneous *McMahon* quality premise.

As one commentator has noted, "The prime purpose of the Act is not to punish, hinder, or impede, but to create a new relationship between investors and those who ask to use his savings."[65] Any compulsory predispute arbitration in the context presented in the facts of these cases is not consistent with a "new relationship," rather it is part of that old creed dispatched by this nation's 73rd Congress. The civil weapons carefully provided to investors by the 1933 Act should not be confiscated by this Court with the optimistic judicial instruction that it is safe now to venture into arbitration forums run by the industry – that one no longer has to worry about those in the industry who, in Senator Ashurst's words, "have sunk their fangs into the pocket books of the innocent investors with greater rapacity than a school of sharks ever sank teeth into human flesh." 72 Cong. Rec. 1019 (1933).

IV. PRINCIPLES OF STARE DECISIS DICTATE THAT WILKO NOT BE OVERRULED

1. What *WILKO* Decided

Wilko posed the following legal question:

> . . . whether an agreement to arbitrate a future controversy is a "condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision" of the Securities Act which § 14 declares "void." [footnote omitted]

Wilko, 346 U.S. at 430.

The Court, having so posed the question, then went on to hold that "This arrangement to arbitrate is a 'stipulation,' and we think the right to select the judicial forum is the kind of "provision" that cannot be waived under section 14 of the Securities Act." *Wilko*, 346 U.S. at 434-5. Having so concluded, the Court stated that " . . . the

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[65] J. Doerfer, *The Securities Act of 1933*, 18 MARQ. L. REV. 147, 171 (1934).

intention of Congress concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration of issues arising under the Act." *Wilko*, 346 U.S. at 438.[66]

Accordingly, including Justice Jackson's concurrence,[67] seven Justices held in *Wilko* that pre-dispute arbitration agreements were *inherently* void under the intent of Congress expressed in the 1933 Securities Act. In the entire majority opinion, and concurring opinion, there appears not one reference to any issue of the *quality* of arbitration, then-extant or otherwise.[68] Indeed there is no direct reference or discussion in the opinion/concurrence of any of the four contractually available arbitration forum options presented on the facts of the case.

That the *Wilko* majority had held that arbitration was *inherently* inconsistent with the Securities Act is further evidenced by the Frankfurter/Minton dissent which began with the reactive:

> If arbitration *inherently* precluded full protection of the rights § 12(2) of the Securities Act affords . . . [emphasis supplied]

Wilko, 346 U.S. at 439.

Following issuance of the *Wilko* opinion there were dozens of case notes and law review articles which uniformly agreed with Petitioners' *Wilko* analysis.[69] Not all

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[66] Petitioners note that *Wilko* dealt with an express cause of action. See *Byrd*, 470 U.S. 225, White, J. concurring.

[67] Which reserved only the question of *post*-dispute agreements to arbitrate.

[68] "There is no mention of this argument of the inadequacies of arbitration [in *Wilko*];" Note, *Securities-Arbitration-Agreements to Arbitrate Are Valid*, 10 U. ARK. LITTLE ROCK L.J. 523,533 (1987-88).

[69] See, for example, Note, *Contracts – Performance And Breach – Whether Arbitration Provision in Stockbrokerage Contract Supersedes Customer's Right to Pursue Judicial Remedy for Violation of Securities Exchange Act*, 32 CHI. KENT. L. REV. 156, 159 (1953-1954).

of the scholarly analysis was necessarily totally supportive of the Court's *Wilko* holding, however there was uniform agreement on *what* that holding had been. That *Wilko* holding has now been cited and accepted in at least 560 *reported* cases.

This *Wilko* ratio was also recognized by this Court in *Scherk* where the majority, in explaining the lower court's reliance on *Wilko*, noted that "*Wilko* . . . held that an agreement to arbitrate could not preclude a buyer of a security from seeking a judicial remedy under the Securities Act of 1933 . . . " *Scherk*, 417 U.S. at 510. The *Scherk* court went on to point out that *Wilko* had held " . . . that an agreement to arbitrate is a 'stipulation' and [that] the right to select the judicial forum is the kind of 'provision' that cannot be waived under § 14 of the Securities Act." *Scherk*, 417 U.S. at 512. The *Scherk* court also noted that there was a "colorable" argument that the 1934 Exchange Act which was before the Court, lacked that "special right" established by § 12(2) of the 1933 Act, *Scherk*, 417 U.S. at 512, and then discussed the 1933 Act's unique jurisdictional provisions. *Scherk*, 417 U.S. at 514. This view of *Wilko*'s holding was also recognized in *Byrd*, 470 U.S. at 224, and was discussed in *McMahon* as well, 107 S. Ct. at 2338.

McMahon, has been viewed as result-oriented jurisprudence[70] wherein the major unarticulated premise is that the case presented the Court with the opportunity to reduce the federal docket.[71] Be that as it may, what the *McMahon* majority could not accomplish, through a rhetorical maze was the defeat of any serious legal analysis whose inescapable conclusion must be that *Wilko* was

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[70] Note, *Who's Protecting the Investors? Shearson/American Express v. McMahon*, 19 ARIZ. ST. L.J. 793, 807 (1987). "The *McMahon* Court's apparent result-oriented reasoning has removed one branch of § 10(b) jurisprudence from public view."

[71] A goal which Petitioners believe to be in any case illusory, particularly under § 11's serial indemnity provisions.

decided on *inherent*,[72] rather than *qualitative*, arbitral characteristics. *Wilko* cannot now be outfitted with a new set of arbitration garments and pushed into retirement with the belief that the retiree can be safely expected to lead an innocuous life thereafter. To do so would not only instantaneously compromise the integrity of the adjudicative process but it would also create the probability of a future reappearances when the inevitable allegations are made that arbitration has deteriorated or that particular arbitration forums do not satisfy the "quality" standard of a retro-fitted *Wilko*.[73]

Petitioners believe, however, that every analysis of the doctrine of stare decisis leads to the inescapable, logical conclusion that *Wilko's* fate should be left to Congress.[74]

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[72] For the view that the lack of equivalent forum choices under the 1934 Exchange Act renders 10(b) claims arbitrable, see Note, *Arbitrability of Claims Arising Under the Securities Exchange Act of 1934*, 1986 DUKE L. J. 548, 566.

[73] Given the arguably greater comparative specificity of the 1933 Act, the practical impact of overruling *Wilko* would surely be to leave *Alexander v. Gardner-Denver Company*, 415 U.S. 36 (1974) (civil rights in employment), *McDonald v. West Branch*, 466 U.S. 284 (1984) (civil rights claim) and *Barrentine v. Arkansas-Best Freight System, Inc.*, 450 U.S. 728 (1981) (Fair Labor Standards Act) as jurisprudential orphans. While the suggestion made in *McMahon* (107 S. Ct. at 2341) is that the new supervisory status of the SEC enhances SRO arbitration forums, Petitioners' view is that the arbitration forums available in *Alexander, McDonald* and *Barrentine* were inherently better than the SEC supervised NYSE and NASD forums available to these Petitioners.

[74] As stated by this Court with respect to its 1950 interpretation of the Federal Tort Claims Act, in justifying adherence to *Feres v. United States*, 340 U.S. 135 (1950), "Nor has Congress changed this standard in the close to 40 years since it was articulated, even though, as the Court noted in *Feres*, Congress 'possesses a ready remedy' to alter a misinterpretation of its intent." *United States v. Johnson*, 107 S. Ct. 2063, 2066 (1987). See

2. Why Stare Decisis Compels Affirmation Of *WILKO*

There is a distinction frequently made and often seen in Supreme Court jurisprudence, between case decisions which involve constitutional questions and case decisions which involve statutory questions.[75] According to those who would make such a distinction, the basic differentiating factor in such distinction is that Constitutional decisions are difficult to alter extra-judicially since alteration would require constitutional amendment, whereas legislative bodies can always respond to statutory decisions.[76] Upon such analysis *Wilko* should now be left to Congress. If Congress disagrees with *Wilko* an amendment to the Securities Act is the simple remedy.

This theory, which is admittedly not entirely free of difficulty, is to the effect that it is the Court's duty to interpret statutes but once having done so, further changes to that interpretive result should be effected by Congress. While it can be argued that Congress ought not to be forced to correct errors made by the Court, or that sometimes it is simply politically not possible to enact such legislative reforms, neither of these arguments is particularly relevant to *Wilko* because there is no evidence that Congress has been unable to effect a legislative reversal nor does *Wilko* present a case of simple legislative acquiescence.

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also, Comments, *Predispute Arbitration Agreements Between Brokers and Investors: The Extension of Wilko to § 10(b) Claims*, 46 MD. L. REV. 339, 377 (1987). "Any policy re-evaluation that would overturn *Wilko* must be left to Congress." The further observation is also made that "The intention of Congress cannot have changed." Id. at 373.

[75] See, for example, *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 405 (1932), Brandeis J., dissenting.

[76] The deference accorded stare decisis in the field of statutory construction is sometimes described as a "super-strong presumption." See Eskridge, *Overruling Statutory Precedents*, 76 GEO. L. J. 1361, 1366 (1988).

In 1975, in the process of amending the 1934 Securities Act, Congress specifically endorsed *Wilko*.[77] While what that endorsement may have signified *with respect to the arbitrability of 1934 Act claims*[78] is disputed, the reference is clearly supportive of *Wilko* per se. It is to be further noted in that regard that the legislative study preceding the 1975 amendments, and the legislative history of the amendments themselves, contain references to at least fifteen specific court decisions. This close Congressional interaction with court decisions in the securities field, seen in the 1975 amendments, continues. Recent amendments to insider trading laws have, for example, specifically overruled *Moss v. Morgan Stanley, Inc.*, 719 F.2d 5 (2d Cir. 1983).[79]

In his recent law review article, Eskridge has suggested that "The willingness of the Supreme Court to reconsider statutory precedents depends upon: (1) the original thoroughness of the Court's consideration of the issue in the precedent; (2) the degree to which Congress has left development of the statutory scheme to the Courts; and (3) the degree to which the precedent has generated public and private reliance."[80]

If a better analysis or better evidentiary record is available (the "proceduralist" exception), then a legislative precedent may be conformed to the better evidence. The thoroughness of *Wilko* and the exhaustive nature of

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[77] "It was the clear understanding of the conferees that this amendment did not change existing law as articulated in *Wilko v. Swan*, 346 U.S. 427 . . . (1953), concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations." H.R. Rep. No. 229, 94th Cong., 1st Sess. 111 (1975), *reprinted in* 1975 U.S. Code Cong. & Ad. News 321, 342.

[78] E.g. *McMahon*, 107 S. Ct. at 2343.

[79] See H.R. 5133, 100th Cong., 2nd Sess. (1988).

[80] Eskridge at 1369.

the legislative history of the 1933 Securities Act generally put *Wilko* beyond the reach of this exception.[81]

Under the Eskridge analysis, this Court's second category of exceptions to the "super-strong" presumption favoring statutory precedents are exceptions for "common law" or "constitutionalized" statutes. Under such analysis the Court's more relaxed stare decisis role in *constitutional* cases can be transferred, as it were, to statutes closely related to developing constitutional provisions. Such exception appears inapplicable to *Wilko* since the 1933 Securities Act was expressly limited to those mature constitutional areas of commerce entrusted to Congress.[82]

The exception suggested with respect to "common law statutes" is predicated upon the notion that when Congress adopts sweeping general public policy measures it is *intended* that the Courts have great latitude in interpreting such statutes. Whether or not one accepts the legitimacy of such an exception to the super-strong statutory stare decisis principle, such exception would not encompass *Wilko* on the basis the oft-made observations that the 1933 Securities Act radically *altered* the common

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[81] "*Wilko* was a carefully considered decision by the Court not unmindful of the objectives of the Arbitration Act and the value of commercial arbitration as a procedure voluntarily agreed to in arms-length negotiations. The Court observed that wholesome securities transactions may be arm's length on equal terms, it is clear that the Securities Act was drafted with an eye to the disadvantages under which buyers labor. Issuers of and dealers in securities have better opportunities to investigate . . . than buyers. It is therefore reasonable for Congress to put buyers of securities covered by that Act on a different basis than other purchasers." [footnote omitted] Bloomenthal, H., *Securities Law Handbook, 1987-88 Edition*, (1987) at CXXXIV.

[82] Other views have been historically advanced that the FAA is built upon the Congressional power over federal courts. See, for example, H. Cohen & K. Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265, 275 (1926).

law, creating, for example, the doctrine of caveat *vendi-tor*,[83] and that the Act was highly detailed.

Finally, the third exception to the "super-strong" legislative prohibition – the degree to which a precedent has generated public and private reliance – suggests again that *Wilko* should not be overruled. The fact that *Wilko* existed, unchallenged for at least thirty years,[84] was cited and incorporated in securities jurisprudence by hundreds of reported cases, congressionally endorsed in 1975, and utilized by the Securities and Exchange Commission,[85] all suggests that the public and private reliance level mitigates most strongly against any judicial alteration of *Wilko*.

Accordingly, on a conventional analysis of this Court's approaches to statutory precedent, *Wilko* ought not be overturned.[86]

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[83] See President Roosevelt's Message to Congress, House Document 12, 73d Cong., 1st Sess., at 2 " . . . let the seller also beware . . . "

[84] It is not even clear that before *McMahon* it can be said that *Wilko* per se was even *questioned* by cases like *Byrd*.

[85] See Securities and Exchange Commission Rule 15c2-2, 17 C.F.R. § 240.15c2-2 (now repealed).

[86] Professor Eskridge would substitute on "evolutive" approach to statutory stare decisis, requiring that all three of his "evolutive tests" be satisfied. According to Eskridge his evolutive test is "a hard test to pass." W. Eskridge at 1388. *Wilko* would clearly not pass his evolutive test and would not therefore, under such evolutive analysis, be altered. For an exhaustive listing of post-1961 relevant case authorities see Eskridge, appendices A-C, *id.* at 1427-39.

Petitioners believe that *Wilko* presents the least theoretically desirable set of facts[87] for precedential overturning and Petitioners further believe that if the Court overrules *Wilko*, public concern as to the overall agenda of this Court, already at a high level, will further increase.

Finally it is instructive that the *McMahon* decision prompted a negative Congressional response.[88]

V. ANY *WILKO* CHANGE SHOULD NOT BE APPLIED RETROACTIVELY

Apart from the contractual intent issue, there remains the broader policy issue of retroactivity. If *Wilko* is to be overruled, should the new rule be applied to all section 12(2) claims regardless of when they arose? It would appear that this Court has traditionally looked to several factors in deciding whether it will retroactively apply a rule enunciated in a case overruling an earlier statutory precedent. Those factors are the extent to which others have justifiably relied on the old rule,[89] the extent to which the new rule's effectiveness is tied to retroactivity,[90] and whether or not retroactive application will pose an administrative burden.[91]

With respect to these Petitioners, who had no intent other than the general intent to place their full trust in Respondent, it is admittedly somewhat difficult to argue *directly* that any *Wilko* change should be prospective only

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[87] Petitioners would suggest, for example, that *Roe v. Wade*, 410 U.S. 113 (1973), presents in logical terms a much more legitimate role for precedential review since unborn children will never have the voice with which to effect constitutional amendment.

[88] See H.R. 4960, 100th Cong., 2nd Sess. (1988).

[89] E.g. *England v. Louisiana State Board of Medical Examiners*, 375 U.S. 411, 422 (1964).

[90] E.g., *Linkletter v. Walker*, 381 U.S. 618, 629 (1965).

[91] E.g., *Johnson v. New Jersey*, 384 U.S. 719, 731 (1966).

because Petitioners *relied* on *Wilko*. However, it *can* be argued that included in Petitioners' trust placed on Respondent, was Petitioners' expectation that Respondent would abide by all relevant laws.[92] Accordingly it is legitimate to argue that, in essence, Petitioners did rely on *Wilko*. It is also true that there would be a significant number of investors with some requisite level of sophistication who signed similar contracts and that *those* investors relied on *Wilko* and that any change in *Wilko*, for that reason, should be *prospective* only. Certainly any such reliance by such investors was fully justifiable since *Wilko* had been in existence for some thirty years, had been Congressionally endorsed in 1975[93] and had been repeatedly explained in the law reviews.[94]

A further retroactivity consideration used by this Court has been the extent, if any, to which any change should be applied retroactively so as to effectuate the new ruling's objective. Since any total reversal of *Wilko* would presumably be to further the goal of the 1925 Arbitration Act to permit parties to agree to arbitrate such disputes as affecting maritime transactions or interstate commerce, considering the contractual intent issue

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[92] Which the document itself suggests would be the case (the form provision read: "Unless unenforceable due to federal or state law, any controversy arising out . . . shall be settled by arbitration").

[93] H.R. Rep. No. 229, 94th Cong., 1st Sess. 111 (1975).

[94] See, for example, *Arbitration Under the Securities Act of 1933*, 49 NW L. REV. 101, 101-3 (1955). "In a recent opinion the Supreme Court finally settled a conflict between the Federal Arbitration Act and the Securities Act of 1933 . . . Mr. Justice Reed, for the majority, reasoned that because the security buyer has so wide a choice of courts and venue, he gives up more than participants in other business transactions when he waives his rights to sue in Courts." [footnotes omitted]

discussed below, it would seem particularly inappropriate to view retroactivity as essential to the furtherance of the new rule's objectives.

Nor would it appear that retroactivity would be dictated under the Court's analysis of the benefit to the administration of justice. Because the applicable § 12(2) statute of limitations period is so short,[95] few existing cases will still be able to utilize *Wilko*, and of that finite number, most could be further purged from the federal docket if prospectivity were imposed as of the date of the *McMahon* decision,[96] a point in time which arguably can be advanced as at least more appropriate.[97]

VI. ANY ALTERATION OF *WILKO* SHOULD NOT BE APPLIED TO THIS CATEGORY OF INVESTOR

Petitioners' overall position is that there are *no* valid agreements to arbitrate in these specific cases. Not only

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[95] Under § 13, the period is basically one year. See *Cook v. Avien, Inc.*, 573 F.2d 685 (1st Cir. 1978).

[96] The retroactive application of *McMahon* to 10(b) claims, seen for example in *Peterson v. Shearson/American Express*, 849 F.2d 464 (10th Cir. 1988) reflects that this Court had never, prior to *McMahon*, ruled an arbitrability of such 10(b) claims. Such facts are radically different from 12(2) claims under the 1933 Act which as noted, have been non-arbitrable under *Wilko* for more than 35 years, and, together with all of the previously noted and relevant stare decisis issues discussed previously, constitute the variety of injustice that would dictate non-retroactivity under *Saint Francis College v. Al-Khazraji*, ___ U.S. ___, 107 S.Ct. 2022, 2025 (1987).

[97] Admittedly, of course, retroactive application (unlike the retroactive application of expanded criminal constitutional rights) might reduce *court* dockets, however, awards will have to be enforced in court.

were the contractual documents adhesive in nature[98] they were also contextually oppressive, substantively unconscionable and beyond the reasonable expectations of Petitioners.[99] The fact is that these investors were either unable to read or comprehend the documents and/or

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[98] The industry overwhelmingly required arbitration in this type of margin agreement. As noted by a SEC official, "Virtually every securities firm in the United States – at least of any appreciable size – uses pre-dispute arbitration clauses, at least in contracts having to do with options and margin trading." 20 Sec. Reg. & L. Rep. (BNA) 101 (Jan. 22, 1988) As shown by the record in this case, this arbitration clause was not a separate portion of the document. With respect to securities industry form documents as contracts of adhesion, see generally, Sterk, *Enforceability of Agreements to Arbitrate: An Examination of the Public Policy Defense*, 2 CARDOZA L. REV. 481 (1981), A. Goldberg, *A Supreme Court Justice Looks At Arbitration*, 20 ARB. J. 13, 16 (1965) (stressing the need to ensure that agreements truly are "voluntary") and J. Di Fiore, *Problems in Alternative Dispute Resolution: Arbitration Agreements as Contracts of Adhesion in Consumer Securities Disputes*, 93 COM. LAW J. 259 (1988).

[99] For a provocative discussion of form contracts and reasonable expectations of the parties, see W. Slawson, *The New Meaning of Contract: The Transformation of Contracts By Standard Forms*, 46 U. PITT L. REV. 21, 35 (1984) where the author suggests that even a commercial buyer " . . . does not expect a requirement that he subject himself to arbitration in a forum of the seller's choice . . . " Slawson's basic thesis is that "the application of well-established common law principles led to the conclusion that standard forms as they were commonly used were not contracts." Id. at 38. It seems highly ironic that the law of merchants offers more protection to the sophisticated businessman than does federal securities law to the unsophisticated investor. See generally, J. Mallor, *Unconscionability In Contracts Between Merchants*, 40 SW L. J. 1065 (1986).

were prevented from making even an attempt to physically examine them.[100] Respondent was bound by not only the trust relationship which was *expressly* verbally extended to each Petitioner, but which is also imposed by the 1933 Act itself.[101]

Accordingly, while the reality is that there were no agreements to submit any of Petitioners' claims to arbitration, however, to the extent that such reality may be contested, Petitioners are compelled to discuss here the *fiction* of the contractual meeting of the minds.

As noted by the Securities and Exchange Commission in their *McMahon* amicus brief[102] arbitrability of

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[100] The following quotation distills some of the important realities touching pre-dispute clauses: "Since much of the [form] agreement looks like legal boilerplate, many investors will not bother to read it. Because they believe the government strictly regulates brokerage houses to insure consumer protection from fraud or unfair dealing, most will not take the agreement to an attorney. They also presume every other investor must and does sign similar agreements . . . Even investors who know they are agreeing to arbitration may not be quite sure what it is." [footnote omitted]. P. Shub, *Shearson/American Express v. McMahon: The Expanding Scope of Securities Arbitration*, 12 NOVA L.REV. 1375, 1375-7 (1988).

[101] The legislative history and relevant law review commentaries are replete with the Brandeis thesis that those who handle "other people's money" have fiduciary duties. As noted elsewhere, President Roosevelt's message to Congress concerning the 1933 Act concluded with the theme of such Act: "those . . . handling or using people's money are trustees acting for others." See J. Landis, *The Legislative History of The Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 30 (1959-60). "It [the 1933 Act] indicted a system as a whole that had failed miserably in imposing those essential fiduciary persons whose function it was to handle other people's money."

[102] Amicus Brief, Securities and Exchange Commission, *Shearson/American Express v. McMahon*, No. 86-44, p. 18, n. 13.

securities fraud claims even under the 1934 Exchange Act, present problems of contractual intent. If one indulges in the fiction that these (or any other investors) both read *and* understand the fine print which purports to adopt arbitration, there remains the further question of whether or not the parties would have *intended* to subject to arbitration, claims which, at point of execution, were clearly not arbitrable but which later might become so.

In the context of § 10(b) claims, perhaps there is some argument that since this Court had not, prior to *McMahon*, definitively ruled one way or the other on arbitrability, that pre-*McMahon* arbitration provisions, in light of an alleged strong pro-arbitration interpretive rule, may be viewed as encompassing § 10(b) fraud claims. Be that as it may, when *these* Petitioners signed relevant documents in 1982 and 1983, it was unchallenged that § 12(2) claims could not be arbitrated *and* that *Wilko* had held any such agreement to be *void*.[103] Something void cannot be resurrected and, in any case, the miracle drug arguably manufactured in *Mitsubishi* and perhaps later in *McMahon*, came too late for *this* Respondent.

If a lawyer had been asked by one of these Petitioners, in 1983, whether or not they could sign a document and still be entitled to litigate § 12(2) claims, the answer would have been a very confident "yes." If an attorney could not rely on *Wilko* as a clear statement of

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[103] Section 14 of the 1933 Act utilizes the term "void". The *Wilko* majority, of course, used the term "invalid." *Wilko*, 346 U.S. at 438. For a discussion of validity, voidness, voidability, and unenforceability in the context of the U.S. Arbitration Act, see Comment, *Fraudulent Inducement As A Defense to the Enforcement of Arbitration Contracts*, 36 YALE L. J. 866 at 869-71 (1926-1927). Petitioners note that § 2 of the U.S. Arbitration Act concludes with "revocation" notwithstanding the fact that such term is preceded by a reference to *three* concepts – "valid," "irrevocable," and "enforceable."

the law in 1983, then the question which surely must be asked is when could any lawyer *ever* give competent advice? Clearly the answer to the overall fiction is that Petitioners could not have *intended* to arbitrate § 12(2) claims nor was the law such as to even make them *competent* to do so.

CONCLUSION

Based on all of the foregoing reasons, the judgment of the United States Court of Appeals for the Fifth Circuit should be reversed and Petitioners' 12(2) claims under the 1933 Securities Act ordered tried in federal district court.

Dated: January 9, 1989
Brownsville, Texas

Respectfully submitted,

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APPENDIX A

STATUTORY AND REGULATORY PROVISIONS INVOLVED

United States Arbitration Act

9 U.S.C. § 2:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 3:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

Securities Act of 1933

Section 12(2), 15 U.S.C. § 77l(2):

> Any person who –
>
> * * *
>
> (2) offers or sells a security (whether or not exempted by the provisions of section 77c of this

title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 14, 15 U.S.C. § 77n:

Any condition, stipulation or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

Section 22(a), 15 U.S.C. § 77v(a):

The district courts of the United States and United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant

is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of Title 28. No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against it in the Supreme Court or such other courts.

Securities Exchange Act of 1934

Section 10, 15 U.S.C. § 78j(b):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 27, 15 U.S.C. § 78aa:

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all

suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts.

Section 29(a), 15 U.S.C. § 78 cc(a):

> Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule or an exchange required thereby shall be void.

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(6)

No. 88-385

Supreme Court, U.S.
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CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

OFELIA RODRIGUEZ DE QUIJAS, et al.,

Petitioners,

v.

SHEARSON/AMERICAN EXPRESS, INC.,

Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF OF RESPONDENT

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QUESTION PRESENTED

Whether the Court's holding in *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S. Ct. 2332 (1987), mandates arbitration of claims asserted under § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2) (1982)?

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-385

OFELIA RODRIGUEZ DE QUIJAS, et al.,

Petitioners,

v.

SHEARSON/AMERICAN EXPRESS, INC.,

Respondent.

BRIEF OF RESPONDENT

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 845 F. 2d 1296, and is reproduced in the Brief in Opposition to the Petition for a Writ of Certiorari ("Brief in Opposition") at Appendix B. The order of the court of appeals denying petitioners' motion for rehearing *en banc* is reported at 850 F. 2d 1582 and is reproduced in the Brief in Opposition at Appendix C. The opinions of the United States District Court for the Southern District of Texas are unreported but are reproduced in the Brief in Opposition at Appendix D and Appendix E.

JURISDICTION

The judgment of the court of appeals was entered on May 31, 1988 and is reproduced in the Brief in Opposition at Appendix F. The Court has jurisdiction pursuant to 28 U.S.C. § 1254(1) (1982).

STATUTES INVOLVED*

United States Arbitration Act

Sec. 2, 9 U.S.C. § 2

Sec. 3, 9 U.S.C. § 3

Securities Act of 1933

Sec. 12(2), 15 U.S.C. § 77*l*(2)

Sec. 14, 15 U.S.C. § 77n

Sec. 22(a), 15 U.S.C. § 77v(a)

Securities Exchange Act of 1934

Sec. 10(b), 15 U.S.C. § 78j(b)

Sec. 27, 15 U.S.C. § 78aa

Sec. 29(a), 15 U.S.C. § 78cc(a)

* The texts of these provisions are reproduced in full at Appendix A hereto.

STATEMENT OF THE CASE

This case involves the enforceability of agreements to arbitrate disputes under § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2). Petitioners opened securities accounts with respondent Shearson Lehman Hutton Inc. ("Shearson"), in a Shearson branch office located in Brownsville, Texas and entered into Customer Agreements with Shearson at or about the time they opened their accounts.[1] Each of these agreements provides that any controversy arising out of or relating to the accounts of petitioners is to be resolved through the arbitration rules of one of three designated self-regulatory organization ("SRO") arbitration forums:

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I [the customer] may elect.

Petitioners filed complaints against Shearson and Mr. Deaton in the United States District Court for the Southern District of Texas on August 23, 1985 and November 27, 1985. Petitioners alleged that there was excessive and unauthorized trading in their accounts, that false statements were made and material facts omitted from the advice given to them, and that certain securities purchased in their accounts were not appropriate in

[1] Petitioners are those individuals listed in the Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit ("Petition"). *See* Petition at 1 n.1. The registered representative who handled petitioners' accounts at Shearson, Jon Grady Deaton, a defendant below, was not a party to the appeal before the court of appeals, is not a party to this proceeding, and is also no longer employed by Shearson. Shearson, named herein as Shearson/American Express, Inc., is a wholly owned subsidiary of Shearson Lehman Hutton Holdings Inc., which is owned in part by the American Express Company and the Nippon Life Insurance Company. E.F. Hutton & Company, Inc. is a wholly owned subsidiary of The E.F. Hutton Group, Inc. which is wholly owned by Shearson.

light of their investment objectives. Petitioners alleged that this conduct constituted violations of: (a) §§ 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. § 77a *et seq.* (1982) (the "Securities Act"); (b) § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (1982) (the "Exchange Act") and Securities and Exchange Commission ("SEC" or "Commission") Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240-10b-5; (c) §§ 15(c)(1) and 15(c)(2) of the Exchange Act and SEC Rules 15cl-2, 15cl-4 and 15cl-6 promulgated thereunder; (d) §§ 206 and 215 of the Investment Advisors Act of 1940, 15 U.S.C. § 80b-1 *et seq.* (1982); (e) the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. 1961 *et seq.* (1982) ("RICO"); (f) various state and common laws; and (g) various rules and regulations of the New York Stock Exchange, Inc. ("NYSE") and the National Association of Securities Dealers, Inc. ("NASD").

Shearson responded to the complaints by filing a motion in the district court for an order dismissing the claims of petitioners asserted under § 17(a) of the Securities Act, 15 U.S.C. § 77q (1982), and for an order enforcing the arbitration agreements of the parties pursuant to § 3 of the United States Arbitration Act, 9 U.S.C. § 1 *et seq.* (1982).

The District Court Opinions

The district court, in an opinion dated November 18, 1986, granted Shearson's motion to dismiss the claims of petitioners asserted under § 17(a) and its motion to stay proceedings pending arbitration of all the remaining claims of petitioners except those asserted under § 12(2) of the Securities Act, and those asserted under the Exchange Act. The district court based its refusal to order the parties to arbitrate their § 12(2) disputes on *Wilko v. Swan*, 346 U.S. 427 (1953), stating that the Court in *Wilko* held that an agreement to arbitrate a § 12(2) claim is prohibited by § 14 of the Securities Act, 15 U.S.C. § 77n, an anti-waiver provision, as an agreement waiving the jurisdictional provision of the Securities Act. This provision of the Securities Act allows a plaintiff to bring suit under the statute in either a federal court or a state court. *See* § 22(a) of the Securities Act, 15 U.S.C. § 77v(a). The district court's refusal to order arbitration of the parties' Exchange Act disputes was based on prior circuit precedent extending the rationale underlying *Wilko* to the Exchange Act. *See* Brief in Opposition, Appendix D at A-18-19.

Shearson filed a motion with the district court on June 29, 1987, requesting that it reconsider its refusal to order the parties to arbitrate the claims asserted by petitioners under § 12(2) of the Securities Act and § 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), based on the Court's opinion in *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S. Ct. 2332 (1987). The Court in *McMahon* held that agreements to arbitrate claims asserted under § 10(b) of the Exchange Act and RICO are enforceable. The district court, in an opinion dated July 14, 1987, ruled that the § 10(b) claims of petitioners were arbitrable but that their § 12(2) claims were nonarbitrable. *See* Brief in Opposition, Appendix E. Shearson appealed the district court's refusal to enforce the parties' agreement to arbitrate their § 12(2) disputes to the United States Court of Appeals for the Fifth Circuit.

The Court of Appeals Opinion

The court of appeals, in an opinion dated May 31, 1988, reversed the district court's order denying Shearson's motion to stay proceedings pending arbitration of the § 12(2) claims of petitioners, and held that the rationale underlying *McMahon* mandates enforcement of agreements to arbitrate § 12(2) claims. *Rodriguez De Quijas v. Shearson/American Express, Inc.*, 845 F. 2d 1296, 1299 (5th Cir.), *reh'g en banc denied*, 850 F. 2d 1582 (1988) (per curiam). The court of appeals denied petitioners' motion for an *en banc* rehearing of its opinion on June 22, 1988. Petitioners filed the Petition on August 31, 1988, requesting that the Court review the order of the court of appeals. Shearson filed the Brief in Opposition on October 20, 1988 which urged the Court to grant certiorari and resolve the post-*McMahon* conflict that exists among the courts of appeals as well as the district courts and state courts regarding the enforceability of agreements to arbitrate § 12(2) claims. The Court granted certiorari on November 14, 1988.

SUMMARY OF ARGUMENT

The Court should affirm the unanimous ruling of the United States Court of Appeals for the Fifth Circuit which enforced the agreements of the parties to arbitrate their disputes under § 12(2) of the Securities Act. The court of appeals held that the Court's contrary decision in *Wilko* was effectively overruled in *McMahon*, wherein the Court held that the Arbitration Act requires enforcement of agreements to arbitrate disputes under § 10(b) of the Exchange Act, because arbitration is adequate to protect substantive rights under the statute.

The Court's opinion in *McMahon* is consistent with its modern arbitration jurisprudence which mandates enforcement of agreements to arbitrate statutory disputes under the Arbitration Act absent evidence of a contrary congressional intent. Such an intent must be expressed in a statute or its legislature history, or in an inherent conflict between arbitration and the statute's underlying purposes. A party opposing arbitration must meet the burden of demonstrating congressional intent to exempt a statute from the Arbitration Act. *See McMahon*, 107 S. Ct. at 2337. This test has been applied by the Court in recent years as the basis for enforcing agreements to arbitrate disputes under the Exchange Act, RICO, the antitrust laws, and other statutory claims. *See McMahon; Perry v. Thomas*, 482 U.S. 483, 107 S. Ct. 2520 (1987); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985); *Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

The Court in *McMahon* applied its arbitrability test to *Wilko* and concluded that *Wilko* was not based on any evidence of congressional intent, but on an unsubstantiated mistrust of arbitration. The Court rejected *Wilko*'s presumption that enforcing an agreement to arbitrate a § 12(2) dispute would result in the loss by an investor of statutory rights. It was this presumption that supported *Wilko*'s conclusion that Congress must have intended the anti-waiver provision in § 14 of the Securities Act to bar waiver of the judicial forum to resolve § 12(2) disputes. The Court held that such a provision prohibits only waiver of substantive obligations imposed by a statute. *See McMahon*, 107 S. Ct. at 2338. Since there are no substantive rights or obligations imposed by a statute which are waived in an arbitration forum, an anti-waiver provision does not prohibit an agreement to arbitrate § 12(2) disputes.

Furthermore, the Court held that arbitration forums subject to SEC oversight, which are the forums at issue in the present case, are adequate to ensure the protection of rights of investors under the Exchange Act. *Id.* at 2341. The SEC's broad oversight authority over the SRO arbitration forums was granted by Congress to the SEC in 1975 and thus did not exist at the time *Wilko* was decided.

The SEC has advised the Court that its authority over the SRO arbitration forums compels the same conclusion for any federal securities law claim brought at these forums, including § 12(2) claims. *See* Brief for the SEC *as Amicus Curiae* in *McMahon* ("SEC *amicus* brief" at 20.) A contrary holding would require the incongruous finding that SRO arbitration is adequate to protect the rights of investors under the Exchange Act but not the Securities Act, when the Court has found no substantive difference between the two statutes and found them to be "interrelated components of the federal regulatory scheme governing transactions in securities." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983). Moreover, a holding that an arbitration forum is inadequate to resolve § 12(2) disputes would be inconsistent with the Court's holding that such a forum is adequate to resolve statutory disputes under the Exchange Act, RICO, the antitrust laws and other statutes.

Accordingly, the Court should place agreements to arbitrate § 12(2) claims on the same footing as agreements to arbitrate any other statutory dispute and reject once and for all the outdated judicial mistrust of arbitration which continues to survive *Wilko*. The Court should not be dissuaded by *stare decisis* concerns in reaching this result since it can either overrule *Wilko* as inconsistent with *McMahon* or limit *Wilko* to prohibit arbitration agreements that designate forums incapable of protecting statutory rights. Should the Court render agreements to arbitrate § 12(2) claims enforceable, that holding should be applied retroactively to the agreement of the parties in the present case.

ARGUMENT

I. Agreements to Arbitrate Claims Asserted Under § 12(2) of the Securities Act of 1933 Should be Enforced Since Congress Did Not Intend to Create an Exception to the United States Arbitration Act For This Statute.

The Arbitration Act provides the starting point for determining whether an agreement to arbitrate a particular dispute is enforceable. *See McMahon*, 107 S. Ct. at 2337. The Act provides that arbitration agreements "shall be valid, irrevocable and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. A court must stay its proceedings under the Act and direct the parties to a valid arbitration agreement to resolve their arbitrable disputes through arbitration. 9 U.S.C. § 3. The Act also authorizes a federal district court to order arbitration when a party to a valid arbitration agreement has failed, neglected or refused to comply with the agreement. 9 U.S.C. § 4.

The legislative history of the Arbitration Act reveals the strong congressional policies underlying the Act and the reasons why Congress enacted this legislation. The Arbitration Act was intended to reverse centuries of judicial hostility to arbitration agreements that had developed in the English Courts, which were fearful of being ousted from their jurisdiction. This judicial hostility was eventually adopted by the American Courts. H.R. Rep. No. 96, 68th Cong., 1st Sess. 1-2 (1924). Congress intended for the Act to prevent courts from refusing to enforce valid contractual agreements of parties to arbitrate their disputes and to enforce these contracts in the same manner as any contract. The Court has held that the desire of Congress to ensure that courts enforce arbitration agreements is the primary policy underlying the Act. *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219-21 (1985). The desire of Congress to allow parties to resolve their disputes expeditiously through arbitration as an alternative to lengthy and costly litigation in a judicial forum

is another congressional policy underlying the Act. H.R. Rep. No. 96, 68th Cong., 1st Sess. at 2; *see also Byrd*, 470 U.S. at 220.

The Court has consistently affirmed the strong congressional policies expressed in the Arbitration Act[2] and has stated that the Act "creates a body of federal substantive law" applicable in both federal and state courts. *See Cone*, 460 U.S. at 24-25 & n.32. The Court has also declared that the Act applies to statutory disputes. *See McMahon*, 107 S. Ct. at 2337 (citing *Mitsubishi*, 473 U.S. at 627). The Arbitration Act applies to a statute unless Congress expressed an intention to prohibit a waiver of judicial remedies for the statutory rights at issue. *McMahon*, 107 S. Ct. at 2337. The burden is on the party opposing arbitration to demonstrate such a contrary congressional intent either in the text or legislative history of the statute or from an inherent conflict between the underlying purposes of the statute and arbitration. *McMahon*, 107 S. Ct. at 2337-38.

Petitioners cannot carry the burden of demonstrating that Congress intended to prohibit a waiver of the judicial forum to resolve disputes under § 12(2) of the Securities Act. Neither the text of the Securities Act nor the legislative history of the securities laws evidences such an intent and there is no conflict between the underlying purposes of § 12(2) and resolving disputes under this statute through arbitration.

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[2] *See, e.g., McMahon; Perry; Mitsubishi; Byrd; Keating; Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983); *Scherk*.

A. The Text of the Securities Act Contains No Evidence of Congressional Intent to Prohibit Enforcement of Agreements to Arbitrate § 12(2) Claims.

There is no language in the text of the Securities Act that evidences an intent of Congress to prohibit a waiver of the judicial forum to resolve § 12(2) disputes. Prior to the Court's opinion in *McMahon*, the only language in the statute that could even arguably be so construed is the anti-waiver provision contained in § 14 which provides: "Any [stipulation] to waive compliance with any provision of [the Securities Act] shall be void." The *Wilko* Court held that an agreement to arbitrate a § 12(2) dispute is a stipulation that impermissibly waives a plaintiff's right to pursue a § 12(2) claim in a judicial forum pursuant to the jurisdictional provision in § 22(a) of the Securities Act. *Wilko*, 346 U.S. at 434-35. The *Wilko* Court reached this conclusion even though neither the anti-waiver provision nor any other provision of the Securities Act discusses arbitration.

1. The Court in *McMahon* Rejected *Wilko*'s Interpretation of an Anti-Waiver Provision as Evidencing Congressional Intent to Prohibit a Waiver of The Judicial Forum to Resolve § 12(2) Disputes.

The Court in *McMahon* found that the *Wilko* Court's interpretation of the anti-waiver provision of the Securities Act was based on the Court's mistrust of arbitration and its belief that only a judicial forum can adequately enforce substantive rights afforded by § 12(2):

> The conclusion in *Wilko* was expressly based on the Court's belief that a judicial forum was needed to protect the substantive rights created by the Securities Act . . . *Wilko* must be understood, therefore, as holding that the plaintiff's waiver of the "right to select the judicial forum" . . . , was unenforceable only because arbitration was judged inadequate to enforce the statutory rights created by § 12(2).

McMahon, 107 S. Ct. at 2338. The *Wilko* Court believed that arbitration is deficient and not capable of protecting rights afforded by § 12(2) of the Securities Act for several reasons. The Court stated that arbitrators are not capable of making "subjective findings on the purpose and knowledge" of an alleged violator of § 12(2) and cannot make legal conclusions "without judicial instruction on the law." *Wilko*, 346 U.S. at 435-36. The Court also believed that arbitration is inadequate to protect statutory rights since an arbitration award "may be made without explanation of [arbitrators'] reasons and without a complete record of their proceedings." *Id.* at 436. Lastly, the *Wilko* Court stated that it was not satisfied that the grounds to review an arbitration award contained in the Arbitration Act are sufficient: "[T]he power to vacate an award is limited," and . . . "interpretations of the law by arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation." *Id.* at 436-37.

The perceived deficiencies of arbitration underlying the *Wilko* Court's interpretation of an anti-waiver provision were found by the Court in *McMahon* to be "the heart of the Court's decision in *Wilko*," and not supported by any evidence.[3] The Court, in opinions rendered subsequent to *Wilko*, has rejected the specific aspects of arbitration described by the *Wilko* Court as deficient:

> [T]he reasons given in *Wilko* reflect a general suspicion of the desirability of arbitration and, the competence of arbitral tribunals – most apply with no greater force to the arbitration of securities disputes

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[3] "As Justice Frankfurter noted in his dissent in *Wilko*, the Court's opinion did not rest on any evidence, either 'in the record . . . [or] in the facts of which [it could] take judicial notice,' that 'the arbitral system . . . would not afford the plaintiff the rights to which he is entitled [under § 12(2)]'." *McMahon*, 107 S. Ct. at 2340 (citing *Wilko*, 346 U.S. at 439 (Frankfurter, J., dissenting)).

than to the arbitration of legal disputes generally. It is difficult to reconcile *Wilko*'s mistrust of the arbitral process with this Court's subsequent decisions involving the Arbitration Act. See, *e.g.*, [*Mitsubishi*, *Byrd*, *Keating*, *Cone*, *Scherk*]. Indeed, most of the reasons given in *Wilko* have been rejected subsequently by the Court as a basis for holding claims to be nonarbitrable.

Id. at 2340.[4]

Since the Court in *McMahon* found that the *Wilko* Court's interpretation of an anti-waiver provision was based solely on an unsubstantiated mistrust of arbitration and not on any discernible evidence of congressional intent, petitioners cannot rely on *Wilko* to support their burden of showing that Congress intended to prohibit agreements to arbitrate § 12(2) disputes.

2. Congress Intended an Anti-Waiver Provision to Prohibit Agreements That Waive Compliance With Substantive Duties Imposed by the Federal Securities Laws.

The Court in *McMahon* corrected the *Wilko* Court's erroneous conclusion that an agreement to arbitrate a § 12(2) claim is void under the anti-waiver provision of the Securities Act as a prohibited stipulation that waives compliance with the jurisdictional provision of the statute. In construing a virtually identical provision in the Exchange Act,[5] the Court in *McMahon* held that an anti-waiver provision was intended by Congress to prohibit enforcement of agreements that waive compliance with substantive duties imposed by a statute. *See Id.* at 2338-43. The Court held that an anti-waiver provision thus does not prohibit a waiver of a statute's jurisdictional provision since the latter provision does not impose any duty with which one must comply. *Id.* at 2338.

[4] The Court has specifically rejected the *Wilko* Court's assumptions that arbitration forums cannot handle the factual and legal complexities of statutory disputes; substantive rights afforded by a statute are lost in arbitration; arbitrators will not follow the law; and judicial review of an arbitration award is insufficient to ensure compliance with the law. *See McMahon*, 107 S. Ct. at 2340 (citing *Mitsubishi*).

[5] *See* § 29(a) of the Exchange Act, 15 U.S.C. § 78cc(a).

The fact that the anti-waiver provision of the Securities Act was intended by Congress to prohibit agreements relieving parties from the duty of substantive compliance with any provision of the statute, such as an exculpatory agreement, rather than an arbitration agreement, is supported by examining the historical use of anti-waiver provisions. Anti-waiver provisions were first utilized in England. *See* L. Loss, *Fundamentals of Securities Regulation* (1983) at 1189 n.51. Prior to 1900, English Courts had honored stipulations which bound purchasers of securities to waive substantive compliance with statutory provisions so long as the courts were satisfied that the party waiving the rights afforded him by a statute was not deceived into signing the agreement. *See*, *e.g.*, *Greenwood v. Leather Shod Wheel Co.*, [1900] 1 Ch. 421, 435-38 (C.A.); *Cackett v. Keswick*, [1902] 2 Ch. 456, 476 (C.A.).

The Parliament enacted identical anti-waiver provisions in sections 38(2) and 417(2) of the Companies Act of 1900 in response to the enforcement by the English Courts of pre-dispute waiver agreements:

> A condition requiring or binding an applicant for shares in or debentures of a company to waive compliance with any requirement . . . shall be void.

11 & 12 Geo. 6, ch. 38, §§ 38(2), 417(2). This anti-waiver provision was intended to prevent parties from waiving compliance with the Companies Act which prevented misrepresentations in connection with the sale of securities that were the subject of a prospectus. *See* 84 Parl. Deb. (4th Ser.) 1161 (1900). Subsequent to the enactment of anti-waiver provisions in England, sellers of securities have been precluded from enforcing predispute agreements which caused purchasers of securities to waive their right to enforce compliance with rights afforded by statutes. *See* L. Loss, *Fundamentals of Securities Regulation* at 1189 n.52. Thus, an anti-waiver provision has historically been utilized to prohibit an agreement that waives compliance with substantive duties imposed by a statute. *See* Fletcher, *Privatizing Securities Disputes Through The Enforcement of Arbitration Agreements*, 71 Minn. L. Rev. 393, 402-03 (1987).

The Court's opinion in *McMahon*, combined with an examination of the historical utilization of an anti-waiver provision, reveals that there is simply no evidence supporting the belief that the enacting Congress intended that § 14 of the Securities Act prohibit an agreement to arbitrate Securities Act disputes. *See* Fletcher, *Learning to Live With the Federal Arbitration Act – Securities Litigation in a Post-McMahon World*, 37 Emory L.J. 99, 110 (1988) ("Fletcher, *Arbitration*").

3. Enforcement of an Agreement to Arbitrate a § 12(2) Dispute Would Not Effect a Waiver of Compliance With Any Duty Imposed by the Securities Act Since Rights Afforded by the Federal Securities Laws Can Be Effectively Vindicated in an Arbitration Forum.

The Court has ruled in all of its recent cases involving the arbitrability of statutory disputes that a prospective litigant may vindicate a statutory cause of action in an arbitration forum since such a forum is capable of enforcing substantive rights and obligations afforded by a statute. *See McMahon*, 107 S. Ct. at 2339 (citing *Mitsubishi*, 473 U.S. at 628).

In no case, with the exception of the Court's discussion of the arbitrability of § 10(b) disputes in *McMahon*, did the Court conduct an independent inquiry into the adequacy of the arbitration forum at issue – rather, it has assumed that arbitrators are capable of applying the law and enforcing statutory rights and obligations. Specifically, the Court did not inquire into the adequacy of the arbitration forums when it held enforceable agreements to arbitrate RICO claims in *McMahon*, antitrust claims in *Mitsubishi*, and § 10(b) claims in *Scherk*, assuming that the designated arbitration forums were adequate to protect the statutory rights at issue.

The Court should assume that arbitration is an adequate forum to resolve rights afforded by § 12(2) of the Securities Act; otherwise, the enforceability of every arbitration agreement will require a preliminary judicial inquiry into the adequacy of the forum, thwarting the contractual right of the parties to obtain a swift resolution of their dispute. To the extent that an arbitration

forum proves to be inadequate to enforce statutory rights in a particular case, a party has ample opportunity after the hearing to move to vacate the arbitration award under the Arbitration Act. The Court has recognized that sufficient statutory safeguards are in place to ensure the effective judicial review of arbitration awards. *See McMahon*, 107 S. Ct. at 2340 (citing *Mitsubishi*, 473 U.S. at 636-37 and n.19); *see also* 9 U.S.C. § 10.

The only reason the Court examined the adequacy of the arbitration forums at issue in *McMahon*, in its discussion of the arbitrability of § 10(b) disputes, was to rebut *Wilko*'s incorrect assumption that arbitration is inadequate to resolve federal securities law disputes. The Court's unanimous holding in *McMahon* that RICO claims are arbitrable without any corresponding analysis of the adequacy of the forum highlights the fact that this is an analysis which the Court does not normally undertake. Nevertheless, the Court in *McMahon* examined the adequacy of the identical arbitration forums at issue in the present case and concluded that they are adequate to protect rights afforded by the securities laws. Accordingly, no duty imposed by the Securities Act is waived by enforcing agreements of parties to arbitrate their disputes at an SRO arbitration forum.

a. The Court in *McMahon* Ruled that Self-Regulatory Organization Arbitration Forums which are Overseen by the Securities and Exchange Commission Are Adequate to Protect the Rights of Investors Under the Federal Securities Laws.

The Court in *McMahon* unequivocally held that arbitration at SRO forums is adequate to protect the rights of investors under the federal securities laws, notwithstanding the *Wilko* Court's contrary conclusion in 1953:

> Even if *Wilko*'s assumptions regarding arbitration were valid at the time *Wilko* was decided, most certainly they do not hold true today for the arbitration procedures subject to the SEC's oversight authority.

McMahon, 107 S. Ct. at 2341.

The Court's finding that SRO arbitration forums are capable of resolving federal securities law disputes was based in large part on the expansive oversight jurisdiction granted by Congress to the SEC in 1975 to regulate these forums. *See McMahon*, 107 S. Ct. at 2341. The Commission's oversight jurisdiction ensures that no amendment to an SRO arbitration rule may occur unless approved by the Commission after providing interested parties an opportunity to comment on the amendment. Moreover, the Commission has the ability on its own initiative, to "abrogate, add to, and delete from" any SRO rule if it finds such changes necessary or appropriate to further the purposes underlying the federal securities laws. *Id.*; *see also* § 19 of the Exchange Act, 15 U.S.C. 78s; SEC *amicus* brief at 13-21. The broad power of the Commission to oversee the SRO forums and ensure their adequacy was not present at the time the Court decided *Wilko*.[6]

The SEC in its *amicus* brief filed in *McMahon* advised the Court that the expansive oversight jurisdiction granted it by Congress in 1975 ensures that SRO arbitration procedures are adequate to protect statutory rights, and that there is no reason to conclude that enforcement of an agreement to arbitrate at an SRO forum would result in a waiver of compliance with any provision of the securities laws. *See* SEC *amicus* brief at 6-7. Furthermore, the SEC represented to the Court that its jurisdiction over SRO arbitration forums ensures that any federal securities law dispute – including § 12(2) disputes – will be adequately resolved at these forums:

> The same conclusion would apply to agreements to arbitrate *any* federal securities-law claim where the arbitration procedures are subject to the Commission's Section 19 authority. Thus, a present-day customer-broker agreement to arbitrate pursuant to SRO arbitration procedures would be enforceable even with respect to claims arising under § 12(2) of the 1933 Act, the section under which the claims in *Wilko* arose, as long as SRO arbitration procedures are specified.

SEC *amicus* brief at 20 (emphasis added).[7]

There is no reasonable basis to conclude that arbitral forums which the Court has ruled are adequate to resolve Exchange Act disputes are not also adequate to resolve Securities Act disputes. In fact, the Court in *McMahon* did not rely on any distinctions between § 12(2) and § 10(b) even though § 12(2) was referred to as a "special right" in *Wilko* since it differs from common law fraud by shifting the burden of proof from the purchaser of a security to the seller. *See Wilko*, 346 U.S. at 431. The dissenting opinion in *McMahon* also refused to accept any argument that the Securities Act is different than the Exchange Act in any substantive manner for purposes of arbitrability. *McMahon*, 107 S. Ct. at 2346-47 and nn.1-2. (Blackmun, J., concurring in part and dissenting in part.)

The Court in *McMahon* was justified in relying on the SEC's oversight jurisdiction in ruling that SRO arbitration forums are adequate to resolve federal securities law disputes. Since 1975, the Commission has sponsored initiatives which have further improved procedures for securities arbitration, that has been conducted for over one hundred years at the NYSE and for over forty years at the NASD. In 1977, the SEC promoted the formation of the Securities Industry Conference on Arbitration ("SICA"), a voluntary association comprised of representatives from the various SROs, the Securities Industry Association, Inc. ("SIA") and the public. SICA developed the Uniform Code of Arbitration ("Uniform Code") which has been expressly adopted by all of the SROs.[8] The SEC solicited public comment on these

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[6] "In 1953, when *Wilko* was decided, the Commission had only limited authority over the rules governing [SROs] and this authority appears not to have included any authority at all over their arbitration rules." *McMahon*, 107 S. Ct. at 2341.

[7] The SEC continues to believe since *McMahon* that SRO arbitration forums are adequate to resolve disputes under any of the federal securities laws. *See* Brief for the SEC as *Amicus Curiae*, *Roney & Co. v. Goren*, No. 88-1874 (6th Cir. 1988) at 4.

[8] *See* SEC *amicus* brief at 17; *see also* Katsoris, *Securities Arbitration After McMahon*, 16 Fordham Urban L.J. 361, 362-64 (1988) ("Katsoris, *Securities Arbitration*").

rules and has expressly approved the Uniform Code and found its rules to be of just and equitable principles of trade. *See* SEC Securities Exchange Act Release No. 16390 (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979).[9] These are the rules followed by the NYSE, NASD and the American Stock Exchange, Inc. ("AMEX"), the arbitration forums approved in *McMahon* and the same forums at issue in the present case. SICA has met regularly since 1977 to consider and propose various improvements to the securities arbitration process.

Arbitration conducted under the Uniform Code at the SRO forums is similar in many respects to a trial. The parties have the right to be present at the hearing of their dispute and can appear *pro se* or be represented by an attorney. They can present an opening statement, call witnesses to testify on their behalf, cross-examine adverse witnesses, introduce documentation into evidence and present closing statements. *See generally* Hoblin, *Securities Arbitration: Procedures, Strategies and Cases* (1988) at 11-1-14. The Uniform Code provides that counsel for the parties and the arbitrators may subpoena witnesses as provided by applicable law.[10] Moreover, the arbitrators have the power to mandate the appearance at a hearing of any person employed by or associated with a member, such as a customer's stockbroker, and to order production of any documents under that person's control, or under any parties' control.[11]

While the SROs sponsor the arbitration forums, they only provide the facilities for parties to resolve their disputes; ultimately, it is the individual arbitrators who decide each case without influence from the SROs. Arbitrators who serve at SRO forums

[9] *See, e.g.*, Arbitration Rules of the New York Stock Exchange, Inc., 2 NYSE Guide (CCH) ¶¶ 2600-2638; Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., NASD Manual (CCH) ¶¶ 3701-3745; Arbitration Rules of the American Stock Exchange, Inc., 2 AMEX Guide (CCH) ¶¶ 9540-9551J; *see also* Katsoris, *Securities Arbitration* at 364.

[10] *See, e.g.*, 2 NYSE Guide (CCH) ¶ 2619 (Rule 169(a)); NASD Manual (CCH) ¶ 3732 (Sec. 32(a)); 2 AMEX Guide (CCH) ¶ 9548 (Rule 608(a)).

[11] *See, e.g.*, 2 NYSE Guide (CCH) ¶ 2620 (Rule 620); NASD Manual (CCH) ¶ 3733 (Sec. 33); 2 AMEX Guide (CCH) ¶ 9549 (Rule 609).

are generally selected based upon their particular expertise in investments, securities law and securities practice. SRO arbitrators are knowledgeable individuals such as attorneys and retired judges, as well as business persons and other individuals possessing extensive experience in resolving securities disputes.[12]

Every effort is made through the Uniform Code to ensure that all parties receive a panel of fair and impartial arbitrators to hear their claims and that even the appearance of partiality is avoided.[13] Every SRO arbitration panel *must* consist of a majority of arbitrators who are not affiliated with the securities industry (*i.e.*, "public" arbitrators). A public customer may, however, obtain an arbitration panel which consists of a majority of arbitrators from the securities industry if he so requests.[14] The existence of a minority of "securities" arbitrators on every arbitration panel ensures that securities industry expertise will be represented and will assist the public arbitrators, when needed, to understand the particular area of the securities industry involved in the dispute.

Prior to the hearing of a dispute, the parties are informed of the business associations of the arbitrators selected to serve on

[12] From 1980 through 1987, 17,390 arbitration cases were filed with the SROs. *See* Fifth Report of the Securities Industry Conference on Arbitration at 7 (1986) and Minutes of the June 24, 1988 Meeting of SICA, which reported arbitration statistics for 1986 and 1987. Many of these cases involved claims by investors under the federal securities laws. A table of the statistics for 1986 and 1987 is attached to the Brief of the Securities Industry Association as *Amicus Curiae* in Support of the Petition for a Writ of Certiorari ("SIA *amicus* brief in support of Petition") at Appendix A.

[13] The Court has presumed arbitrators to be impartial: "We decline to indulge the presumption that the parties and arbitral body conducting a proceeding will be unable or unwilling to retain competent conscientious, impartial arbitrators." *Mitsubishi*, 473 U.S. at 634.

[14] *See, e.g.*, NYSE Guide (CCH) ¶ 2607 (Rule 607(a)); NASD Manual (CCH) ¶ 3719 (Sec. 19); 2 AMEX Guide (CCH) ¶ 9542 (Rule 602(a)); *see also* Katsoris, *Securities Arbitration* at 376-77.

the panel.[15] This gives the parties grounds for the use of a challenge for cause to remove an arbitrator from the panel. The Uniform Code provides that the parties have unlimited challenges for cause and one peremptory challenge to remove arbitrators from the panel.[16] Each arbitrator is required to disclose "any circumstances which might preclude such arbitrator from rendering an objective and impartial determination."[17] Arbitrators who even appear to have a conflict of interest may be disqualified for cause.[18]

Additionally, parties who resolve their disputes through SRO arbitration forums are protected from improper arbitration awards under the Arbitration Act to the same extent as parties to any arbitration proceeding. The Arbitration Act provides that a court may vacate an arbitration award when it is established that the award was tainted by (1) corruption, fraud or undue means; (2) evident partiality or corruption on the part of an arbitrator; (3) misconduct on the part of an arbitrator; or (4) the exceeding or improper execution of an arbitrator's powers. 9 U.S.C. § 10. Furthermore, while an arbitration award will not be set aside due to a misinterpretation of the law by an arbitrator, courts will vacate an award which is found to be "in manifest disregard of the law."[19] Two additional judicially-created grounds

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[15] *See, e.g.*, 2 NYSE Guide (CCH) ¶ 2608 (Rule 608); NASD Manual (CCH) ¶ 3721 (Sec. 21); 2 AMEX Guide (CCH) ¶ 9542 (Rule 602(d)).

[16] *See, e.g.*, 2 NYSE Guide (CCH) ¶ 2609 (Rule 609); NASD Manual (CCH) ¶ 3722 (Sec. 22); 2 AMEX Guide (CCH) ¶ 9542 (Rule 602(e)).

[17] *See, e.g.*, 2 NYSE Guide (CCH) ¶ 2610 (Rule 610); NASD Manual (CCH) ¶ 3723 (Sec. 23); 2 AMEX Guide (CCH) ¶ 9542 (Rule 602(f)).

[18] *Id.*

[19] *See, e.g., O. R. Securities, Inc. v. Professional Planning Associates, Inc.*, 857 F. 2d 742, 746 (11th Cir. 1988); *Jenkins v. Prudential-Bache Securities, Inc.*, 847 F. 2d 631, 634 (10th Cir. 1988); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F. 2d 930, 933 (2d Cir. 1986); *Stroh Container Co. v. Delphi Indus., Inc.*, 783 F. 2d 743, 749 (8th Cir.), *cert. denied*, 476 U.S. 1141 (1986); *Siegel v. Titan Indus. Corp.*, 779 F. 2d 891, 892 (2d Cir. 1985); *(footnote continued)*

to vacate an arbitration award are when the award is deemed: (1) contrary to public policy or (2) irrational.[20] Although admittedly limited, the grounds to vacate an arbitration award have been expressly found by the Court to be sufficient to ensure that arbitrators comply with the requirements of a statute. *See McMahon*, 107 S. Ct. at 2340 (citing *Mitsubishi*, 473 U.S. at 636-37).

Given these safeguards it is not surprising to note that investors were awarded monetary damages in 55% of the 2,936 SRO arbitrations which were not settled and were conducted through decision in 1987.[21]

b. The SEC Has Acted Since *McMahon* to Ensure the Continued Adequacy and Fairness of the Rules Governing SRO Arbitration Forums.

The SEC has acted since *McMahon* to ensure the continued adequacy and fairness of the SRO arbitration forums by proposing changes to the Uniform Code. These changes were recommended to SICA and the SROs by letter dated September 10, 1987, wherein the SEC reviewed an examination of the SRO arbitration forums it had undertaken over the previous eighteen months and concluded that they operate fairly and efficiently.[22] The SEC requested SICA and the SROs to review its proposals and make their own specific recommendations.

(footnote continued)

Drayer v. Krasner, 572 F. 2d 348, 352 (2d Cir.), *cert. denied*, 436 U.S. 948 (1978); *Swift Indus., Inc. v. Botany Indus. Inc.*, 466 F. 2d 1125, 1130 (3d Cir. 1972); *San Martine Campania de Navegacion v. Saguenay Terminals, Ltd.*, 293 F. 2d 796, 801 (9th Cir. 1961).

[20] *See, e.g., Amoco Overseas Oil Co. v. Astir Navigation Co.*, 490 F. Supp. 32, 37 (S.D.N.Y. 1979); *Botany Indus. v. New York Joint Board*, 375 F. Supp. 485, 490 n.6 (S.D.N.Y.), *vacated on other grounds sub nom., Robb v. New York Joint Board*, 506 F. 2d 1246 (2d Cir. 1974).

[21] *See* SIA *amicus* brief in Support of Petition at 11 & Appendix A.

[22] *See* Letter from Richard G. Ketchum, Director of the Division of Market Regulation of the SEC to all SICA Members (September 10, 1987), *reprinted in* Fitterman, McGuire & Love, *SEC Initiatives for Changes in SRO Arbitration Rules*, 601 PLI 257 (1988) at Appendix A ("SEC Letter"); *see also* SEC *amicus* brief (SRO arbitration forums are adequate to protect statutory rights).

The SEC was especially concerned with the suggestion in the dissenting opinion in *McMahon* that there may be an appearance of bias in favor of the securities industry at the SRO forums, notwithstanding the lack of any evidence to support such a perception.[23] Accordingly, the SEC recommended and the SROs proposed rule changes which would redefine the term "public arbitrator" to ensure that individuals with even marginal ties to the securities industry, such as retired industry personnel, not be included among the public non-industry arbitrators who comprise the majority of every SRO arbitration panel.[24] Furthermore, the rule changes would also require the SRO forums to provide parties with the names and ten-year employment history of all arbitrators selected to serve on a panel.[25] These rule changes make it clear that the SEC and the SROs seek to avoid even a perception of bias.

The SROs have also proposed changes to the Uniform Code which are designed to ensure that an investor voluntarily enters into an arbitration agreement. These proposals require brokerage firms to highlight an arbitration clause in their Customer Agreements and also require that the clause be written in plain English and specify the judicial remedies which an individual waives by agreeing to arbitration.[26] This will ensure that an investor

[23] Constantine N. Katsoris, a Professor of Law at Fordham University School of Law, who has been a Public Member of SICA since its inception in 1977 and who has been widely recognized as a leading commentator on securities arbitration, categorically rejects the statement in the dissenting opinion that there is a "stacked deck" in favor of the securities industry at the SRO arbitration forums. *See McMahon*, 107 S. Ct. at 2355 (Blackmun, J., concurring in part and dissenting in part). Professor Katsoris, who serves as an arbitrator at the NYSE and NASD, states: "In over fifteen years of sitting as a public arbitrator, it has been this author's experience that the securities arbitration procedures have, to date, resulted in an overall good faith effort to provide fair resolution of public securities disputes." Katsoris, *Securities Arbitration* at 384.

[24] *See, e.g.*, Rule 607(a) of the Proposed Amendments to the NYSE Arbitration Rules as filed with the SEC on October 17, 1988 ("Proposed Amendments to the NYSE Arbitration Rules"), a copy of which is attached to the Brief of the SIA as *Amicus Curiae* in Support of Respondent at A-4-5.

[25] *See Id.* at A-7-8 (Rule 611).

[26] *See Id.* at A-19 (Rule 637).

will voluntarily enter into an arbitration agreement. The changes also provide for standardized discovery timetables and a pre-hearing discovery conference conducted by the arbitrators when requested by either party.[27] Finally, the SROs have also proposed that future arbitration awards state the issues involved, the damages claimed and the amount actually awarded.[28]

To date, the NYSE, NASD, AMEX, the Midwest Stock Exchange, Inc., the Municipal Securities Rulemaking Board ("MSRB"), and the Pacific Stock Exchange, Inc. have filed requests with the SEC for approval of these and other amendments to its rules pursuant to § 19(b)(1) of the Exchange Act, 15 U.S.C. § 78s(b)(1). The SEC has to date published the proposed amendments to the NYSE, NASD, AMEX and MSRB arbitration rules and has requested comments from the public and all interested persons.[29] Presumably, the other SROs will also file proposed amendments to their arbitration rules with the Commission which will be consistent with SICA's proposals once the Commission approves the proposals pending before it.

The SEC, SICA and the SROs have a delicate assignment in balancing the demands of greater discovery and other changes in the Uniform Code designed to improve the system for all parties, with the desire to maintain the fundamental nature of the securities arbitration process which makes it so appealing:

> What is attractive about arbitration is that it is generally speedy, economical and fair. Obviously, improvements can always be made; but we should retain the basic characteristics of arbitration. The dangers in the post-*McMahon* era are efforts to recast arbitration as a clone to litigation.... Simply put, the lengthy litigation, excessive costs and delay

[27] *See Id.* at A-12-14 (Rule 619).

[28] *Id.* at A-15-16 (Rule 627).

[29] *See* 54 Fed. Reg. No. 16 (Jan. 26, 1989) at 3883-86 (Notice of NYSE filing); 53 Fed. Reg. No. 218 (Nov. 10, 1988) at 45640-43 (Notice of NASD filing); 54 Fed. Reg. No. 16 (Jan. 26, 1989) at 3878-80 (Notice of AMEX filing); 54 Fed. Reg. No. 15 (Jan. 25, 1989) at 3705-08 (Notice of MSRB filing).

> prevalent in our court system is hardly the answer either for the securities industry or the public it serves. . . . Indeed, justice delayed, or made prohibitively costly, often results in justice denied.

Katsoris, *Securities Arbitration* at 370-371.

The Court should render agreements to arbitrate claims asserted under § 12(2) of the Securities Act enforceable due to the fairness and adequacy of SRO arbitration, and the fact that the Commission has continued to act to ensure that these forums remain fair and alleviate any perception that they are biased towards the securities industry. Such a result will hopefully remove the remaining judicial hostility against agreements to arbitrate securities law disputes which has lingered since *Wilko*, creating an unsubstantiated exception to the general assumption that an arbitration forum is capable of resolving statutory disputes. Only then will the congressional endorsement of arbitration be fully realized.[30]

B. The Legislative History of the Federal Securities Laws Contains No Evidence of Congressional Intent to Prohibit a Waiver of the Judicial Forum to Resolve § 12(2) Disputes.

The legislative history of both the Securities Act and the Exchange Act is devoid of any language evidencing congressional intent to prohibit arbitration of claims asserted under § 12(2) of the Securities Act. Petitioners contend that the Court should interpret as evidence of such intent both a passing reference to *Wilko* in a 1975 Conference Report underlying congressional amendments to § 28(b) of the Exchange Act, 15 U.S.C. § 78bb(b), and securities arbitration legislation introduced into Congress in

[30] Since an arbitration forum can adequately resolve disputes under § 12(2) of the Securities Act, there is no conflict between the purposes underlying the statute and arbitration. The Securities Act was generally designed to provide investors with full disclosure of material information concerning public

(footnote continued)

July 1988, one year after the *McMahon* decision. *See* Petitioners' Brief at 15-16, 43 and n.88. An analysis uncovers no evidence of congressional intent to bar arbitration of these claims in these actions of Congress and suggests that at most Congress desired in both instances to leave resolution of the arbitrability of federal securities law disputes to the courts.

1. The 1975 Amendments to the Securities Laws Did Not Result in a Congressional Ratification of *Wilko* But Rather Evidenced the Desire of Congress to Leave the *Wilko* Issue to the Courts.

In 1975, Congress made sweeping revisions to the Exchange Act designed in large part to clarify the expansive scope of SRO responsibilities and provide SROs with sufficient means of exercising "governmental-type" powers to effectively carry out their responsibilities under the Exchange Act. *See McMahon*, 107 S. Ct. at 2342 (citing S. Rep. No. 94-75, p. 22 (1975)). Among these revisions was an amendment to § 28(b) which furthered the ability of an SRO to police its members. The Conference Report to the § 28(b) amendment contained the following language:

> It was the clear understanding of the conferees that this amendment did not change existing law as articulated in *Wilko v. Swan*, 346 U.S. 427 [74 S. Ct. 182, 98 L. Ed. 168 (1953)], concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations.

H.R. Rep. No. 229, 94th Cong., 1st Sess. 111 (1975). Petitioners argue that this sentence in the Conference Report resulted in a congressional ratification of *Wilko*.

(footnote continued)
offerings of securities in interstate commerce. *See* H.R. Rep. No. 85, 73d Cong., 1st Sess. 1-5 (1933). Section 12(2) makes it unlawful for any person who offers or sells a security by means of a prospectus or oral communication to materially misrepresent the nature of the security to a purchaser. These purposes underlying § 12(2) of the Securities Act will be enforced by an arbitration forum that is called upon to resolve a § 12(2) dispute.

The Court in *McMahon* has already established that this sentence did not result in a congressional ratification of *Wilko* and that Congress intended to leave the *Wilko* issue to the courts:

> [T]he *Wilko* issue was left to the courts: it was unaffected by the amendment to § 28(b). This statement of congressional inaction simply does not support the proposition that the 1975 Congress intended to engraft onto unamended § 29(a) a meaning different from that of the enacting Congress.

See McMahon, 107 S. Ct. at 2342-43. The McMahons argued that Congress had ratified the holdings of courts of appeals rendering § 10(b) disputes nonarbitrable since the sentence in the Conference Report evidenced congressional awareness of *Wilko*, the courts of appeals had extended the rationale underlying *Wilko* to § 10(b), and Congress did not act to legislatively alter these holdings. *Id.* The Court rejected this theory of congressional ratification since it found that the amendment to § 28(b) was related solely to preserving the self-regulatory role of the SROs and did not involve arbitration between member firms and their customers:

> [T]he amended version of § 28(b), like the original, mentions neither customers nor arbitration. It is directed at an entirely different problem: enhancing the self-regulatory function of the SROs under the Exchange Act.

McMahon, 107 S. Ct. at 2342.

The Court's interpretation of this Conference Report applies equally to the present case. The sentence in the Conference Report at most indicates that Congress desired to clarify that it was only legislating in the area of dispute resolution between the SROs and its members, and it did not "otherwise intend to affect *Wilko*'s construction of the Securities Act." *Id.* This is highlighted by the fact that the sentence in the Conference Report at issue underlies amendments to the Exchange Act and not the Securities Act.

The Court in *McMahon* rejected *Wilko*'s construction of § 14 of the Securities Act as evidencing congressional intent to prohibit an agreement to arbitrate a § 12(2) dispute, and found that *Wilko* was based solely on the Court's mistrust of arbitration and not on any evidence of congressional intent to prohibit arbitration of § 12(2) disputes. The Court should likewise reject petitioners' argument that the sentence in the Conference Report which underlies the amendments to § 28(b), along with the failure of Congress to legislatively alter *Wilko*, constitutes evidence of congressional intent to ratify *Wilko*. This single sentence cannot overcome the clear and unequivocal intent of Congress when it enacted the Securities Act and did not exempt the statute from the Arbitration Act. Petitioners' argument highlights why the Court, in analyzing similar arguments, has commented that "[i]t is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law." *See Girouard v. United States*, 328 U.S. 61, 69 (1946); *see also Boys Markets, Inc. v. Retail Clerk's Union, Local 770*, 398 U.S. 235, 241-42 (1970).[31]

An interpretation of the Conference Report to not prohibit agreements to arbitrate § 12(2) disputes also uniformly applies the Court's interpretation and application of congressional intent underlying the 1975 amendments to the Securities Act and the Exchange Act. The court of appeals found it implausible that Congress in 1975 intended the courts to resolve the arbitrability of § 10(b) disputes but did not intend them to resolve the arbitrability of § 12(2) disputes:

> [Appellees] claim that Congress, by preserving *Wilko* in the 1975 revisions of the Exchange Act manifested its intent that at least § 12(2) claims should remain non-arbitrable. We find it implausible that Congress intended to prohibit arbitration of Securities Act claims but intended to allow courts to determine the

[31] *See also Hirschey v. F.E.R.C.*, 777 F.2d 1, 7-8 (D.C. Cir. 1985) (Scalia, J. concurring) (criticizing routine deference to detail of congressional committee reports).

> arbitrability of Exchange Act claims. Similarly fine distinctions between the two Acts have been presented throughout the course of the debate over securities arbitration. . . . We do not, however, find these asserted distinctions controlling on the issue of arbitration.

Rodriguez, 845 F. 2d at 1299 (citations and footnotes omitted). Accordingly, the Court should affirm the court of appeals' finding that Congress did not ratify *Wilko* through the 1975 amendments.

2. Recent Congressional Action Further Evidences That Congress Has Left the *Wilko* Issue to the Courts.

The Court should also reject the argument of petitioners that the introduction of the "Securities Arbitration Reform Act of 1988", H.R. Rep. No. 4960, 100th Cong., 2d Sess. (1988), into Congress evidenced an intent of Congress to ratify the *Wilko* Court's interpretation of the anti-waiver provision of the Securities Act. *See* Petitioners' Brief at 16 & n.20. In the first instance, this bill cannot evidence congressional intent on any issue since it was never enacted into law and, as petitioners concede, never left the House Committee on Energy and Commerce. *See* Petitioners' Brief at 16 n.20. Furthermore, even assuming that the Act was enacted in a form identical to that in which it was introduced last year, it cannot even liberally be read as evidencing congressional intent to ratify *Wilko* or to legislatively overrule *McMahon*.

The proposed legislation sought to amend § 15(c) of the Exchange Act, 15 U.S.C. § 78c(c) by requiring that the SEC promulgate rules ensuring that investors make a knowledgeable choice about arbitration prior to signing an agreement. The bill also required that basic information be included in an arbitration award; that public arbitrators constitute a majority of each panel; and that parties be given additional background information on arbitrators. *See* H.R. Rep. No. 4960, 100th Cong., 2d Sess. at 2-6. Finally, the bill would have amended § 29(a) of the Exchange Act to state that an anti-waiver provision would not render as void an arbitration agreement that conformed with the proposed legislation. *Id.* at 6-7

The bill thus sought only to improve the arbitral process while ensuring that a public customer voluntarily enters into an arbitration agreement with a member firm.[32] Had Congress intended to ratify *Wilko* and/or overrule *McMahon*, it could have simply proposed legislation which would have amended the anti-waiver provision of the Securities Act and/or Exchange Act to prohibit the utilization by a member firm of a pre-dispute arbitration agreement with a public customer. The contents of the recently proposed legislation, combined with the failure of Congress to enact or even propose an amendment to the anti-waiver provisions of the securities laws to prohibit pre-dispute arbitration agreements, comports with the Court's finding in *McMahon* that Congress intended to leave the "*Wilko* issue" to the courts. *McMahon*, 107 S. Ct. at 2343.

II. The Court Should Enforce Agreements to Arbitrate § 12(2) Claims Without Being Deterred by *Stare Decisis* Concerns.

The Court should not be deterred by *stare decisis* concerns from enforcing agreements to arbitrate § 12(2) claims. The Court created the doctrine of *stare decisis* to enable individuals to conduct themselves in a manner consistent with the Court's precedents. The doctrine also prevents cases and issues from being continuously litigated which would impinge upon the Court's ability to orderly and efficiently administrate justice, or which would undermine public faith in the judiciary.[33] The important principles embodied in the doctrine of *stare decisis* should continue to be furthered by the Court in appropriate cases. The Court has made it clear, however, that *stare decisis* is not a mechanical formula and does not protect precedents from being overturned which are outdated and do not reflect the current state of the law:

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[32] All of the provisions of the bill seeking to improve the arbitral process are already part of the Uniform Code utilized by the SROs or are amendments to the Uniform Code proposed by SICA and the proposed changes to the rules of the SROs pending before the Commission for approval.

[33] *See Moragne v. State Marine Lines*, 398 U.S. 375, 403 (1970); *Helvering v. Hallock*, 309 U.S. 106, 119 (1940); *Florida Dep't. of Health v. Florida Nursing Home Assoc.*, 450 U.S. 147, 154 (1981) (Stevens, J., concurring).

> [S]*tare decisis* is a principle of policy and not a mechanical formula of adherence to the latest decision, however recent or questionable, when such adherence involves collision with prior doctrine more embracing in its scope, intrinsically sound, and verified by experience.

Boys Markets, 398 U.S. at 241 (citing *Helvering*, 309 U.S. at 119; *Swift & Co. v. Wickham*, 382 U.S. 111, 116 (1965)). Accordingly, the Court has historically overruled outdated precedents which involved statutory interpretation:

> [W]e have explicitly overruled statutory precedents in a host of cases. *See, e.g., Monell v. New York City Department of Social Services*, 436 U.S. 658 (1978), overruling *Monroe v. Pape*, 365 U.S. 167 (1961); *Continental T.V., Inc. v. GTE Sylvania*, 433 U.S. 36 (1977), overruling *United States v. Arnold Schwinn & Co.*, 388 U.S. 365 (1967); *Machinists v. Wisconsin Employment Relations Comm'n*, 427 U.S. 132 (1976), overruling *Machinists v. Wisconsin Employment Relations Bd.*, 336 U.S. 245 (1949); *Braden v. 30th Judicial Circuit Court of Kentucky*, 410 U.S. 484 (1973), overruling *Ahrens v. Clark*, 335 U.S. 188 (1948); *Andrews v. Louisville & Nashville R. Co.*, 406 U.S. 320 (1972), overruling *Moore v. Illinois Central R. Co.*, 312 U.S. 630 (1941); *Boys Markets, Inc. v. Retail Clerks*, 398 U.S. 235 (1970), overruling *Sinclair Refining Co. v. Atkinson*, 370 U.S. 195 (1962); *Peyton v. Rowe*, 391 U.S. 54 (1968), overruling *McNally v. Hill*, 293 U.S. 131 (1934). These actions do not mean the Court has been insensitive to considerations of *stare decisis*, but only that we recognize it as "a principle of policy and not a mechanical formula." *Boys Markets*, [398 U.S. at 241] (quoting *Helvering v. Hallock*, 309 U.S. 106, 119 ... (Frankfurter, J.)).

Patterson v. McLean Credit Union, 108 S. Ct. at 1419, 1420-21; *see also Commissioner of Internal Revenue v. Estate of Church* 335 U.S. 632 (1949).

Since *Wilko* has been effectively overruled by the Court in *McMahon*, the Court can expressly overrule *Wilko* without impediment from the doctrine of *stare decisis* and render enforceable agreements to arbitrate § 12(2) disputes. Alternatively, the Court can render such agreements enforceable when the designated arbitration forum is capable of enforcing statutory rights under the federal securities laws, such as an SRO forum. Such a holding would be consistent with *McMahon* and *Scherk* and not infringe on the doctrine of *stare decisis*.

A. The Court Should Overrule *Wilko* Since It Has Subsequently Ruled That an Arbitration Forum Is Adequate to Protect Statutory Rights.

The Court should overrule *Wilko* and render agreements to arbitrate § 12(2) disputes enforceable since *Wilko*'s mistrust of arbitration was based upon its belief – since rejected by the Court – that arbitration is inadequate to enforce statutory rights:

> [T]he mistrust of arbitration that formed the basis for the *Wilko* opinion in 1953 is difficult to square with the assessment of arbitration that has prevailed since that time.... Indeed, most of the reasons given in *Wilko* have been rejected subsequently by the Court as a basis for holding claims to be nonarbitrable.

McMahon, 107 S. Ct. at 2340-41.

McMahon is a precedent which provides uniformity in the Court's recent decisions interpreting the Arbitration Act and it is *McMahon* that the Court should defer to under the principles of *stare decisis* and not *Wilko*. Should the Court uphold *Wilko*, it would create a conflict with *McMahon* and the Court's interpretation of identical provisions of the Securities Act and the Exchange Act and would continue to foster the type of judicial hostility towards arbitration that it has labored to eliminate.

The great weight of authority has interpreted the Court's opinion in *McMahon* as overruling *Wilko* and, in fact, the dissenting opinion in *McMahon* recognized that "the Court effectively overrule[d] *Wilko*." *McMahon*, 107 S. Ct. at 2346. The majority of opinions of the courts of appeals, district courts and state

courts have held that *McMahon* effectively overruled *Wilko*.[34] Scholars and commentators have also reached the same conclusion. *See, e.g.*, Note, *The Arbitrability of Federal Securities Claims: Wilko's Swan Song*, 42 U. Miami L. Rev. 203, 227 (1987) ("One may ponder, What is left of the *Wilko* doctrine? This Note suggests that the answer is – nothing.").[35]

The policies underlying the doctrine of *stare decisis* are served not only by preserving precedents that accurately reflect the current state of the law, but also by formally recognizing that in certain instances precedents are outdated and should be recognized as such. Since the Court has rendered *Wilko* an outdated precedent and the great weight of authority has recognized this fact, individuals can no longer justifiably rely on *Wilko* to govern their affairs and this outdated precedent should be expressly overruled by the Court without impediment from the doctrine of *stare decisis*.

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[34] Shearson is aware of forty-one cases nationwide that have decided the enforceability of agreements to arbitrate claims asserted under § 12(2) and other sections of the Securities Act since the Court decided *McMahon*. The courts of appeals are split on the issue. The Fifth and Tenth Circuit Courts of Appeals have stated that the rationale underlying *McMahon* renders agreements to arbitrate § 12(2) claims presently enforceable. *See Rodriguez*, 845 F. 2d 1296 (5th Cir.), *reh'g en banc denied*, 850 F. 2d 1582 (1988) (per curiam); *Peterson v. Shearson/American Express, Inc.*, 849 F. 2d 464, 466 (10th Cir. 1988). The Second and Third Circuit Courts of Appeals have held that agreements to arbitrate § 12(2) claims continue to be unenforceable based on *Wilko* since the Court did not expressly overrule *Wilko* in *McMahon*. *See Chang v. Lin*, 824 F. 2d 219, 222 (2d Cir. 1987); *Osterneck v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 841 F. 2d 508, 512 (3d Cir. 1988). Twenty-two district court and state court cases nationwide have held that agreements to arbitrate § 12(2) and other Securities Act claims are enforceable based on *McMahon* while fifteen district court and state court cases have held such agreements unenforceable based on *Wilko*. A complete list of these district court and state court cases is contained at Appendix B.

[35] *See also The Supreme Court, 1986 Term – Leading Cases*, 101 Harv. L. Rev. 119, 286 n.46 (1987); Shell, *Res Judicata and Collateral Estoppel Effects of Commercial Arbitration*, 35 U.C.L.A. L. Rev. 623, 639 n.84 (1988); Fletcher, *Arbitration* at 113; Brunet, *Questioning the Quality of Alternate Dispute Resolution*, 62 Tulane L. Rev. 1, 43 (1987).

B. The Court Can Follow Its Holding in *McMahon* And Enforce Agreements to Arbitrate § 12(2) Disputes at an SRO Forum Without Overruling *Wilko*.

The Court in *McMahon* established that an agreement to arbitrate a federal securities law dispute is enforceable as long as the designated forum is capable of protecting statutory rights. The Court ruled that *Wilko*'s refusal to enforce such an agreement was based on its finding that arbitration was inadequate to protect statutory rights:

> *Wilko* must be read as barring waiver of a judicial forum only where arbitration is inadequate to protect the substantive rights at issue.

McMahon, 107 S. Ct. at 2339.

The SRO forums designated in the arbitration agreement of the parties in the present case were expressly held in *McMahon* to be capable of protecting rights afforded by the Exchange Act, and they should be rendered enforceable in the present case to enforce rights afforded by the Securities Act, since there is no justifiable reason to construe the statutes differently for purposes of arbitrability.

Such an approach is also consistent with that taken by the Court in *Scherk*, where it ruled that an agreement to arbitrate a § 10(b) dispute was not prohibited by the anti-waiver provision of the Exchange Act. The *Scherk* Court assumed for purposes of its opinion that *Wilko* applied to § 10(b) of the Exchange Act. *McMahon*, 107 S. Ct. at 2340. Nevertheless, the Court ruled that the parties' agreement was enforceable since "arbitration was an adequate substitute for adjudication as a means of enforcing the parties' statutory rights" under the circumstances of that case which involved an international transaction. *Id.* at 2339. As the Court in *McMahon* concluded: "*Scherk* supports our understanding that *Wilko* must be read as barring waiver of a judicial forum only where arbitration is inadequate to protect the substantive rights at issue." *Id.*

This analysis allows *Wilko* to prohibit federal securities law claims from being arbitrated in an arbitration forum that is incapable of protecting statutory rights while prohibiting *Wilko* from barring arbitration of federal securities law claims at an SRO forum. *See* SEC *amicus* brief at 20-21.

III. A Ruling by the Court that an Agreement to Arbitrate A § 12(2) Dispute is Enforceable Should be Applied Retroactively to the Agreement of the Parties in the Present Case.

In the event the Court rules that an agreement to arbitrate a § 12(2) dispute is enforceable, that ruling should apply to the agreement of the parties in the present case, since the Court has held that a case should be controlled by the law existing at the time of the decision rather than that existing prior to or during the lawsuit. *See St. Francis College v. Al-Khazraji*, 107 S. Ct. 2022, 2025 (1987).[36] The Court has developed a limited exception to this rule to prevent a retroactive application of a decision which alters prior precedent and produces clearly unforeseen or substantially inequitable results. The test to be applied when considering whether to prevent a retroactive application of a decision is articulated in *Chevron Oil v. Huson*, 404 U.S. 97 (1971), which instructs that intervening decisions of the Court which establish a new principle of law should not be applied retroactively when the decision: (1) overrules clear past precedent on which litigants may have relied or involves an issue of first impression whose resolution was not clearly foreshadowed, or (2) would produce substantial inequitable results. *Chevron*, 404 U.S. at 106-07. The *Chevron* test also requires that a court examine the history of the rule of law in question and its purposes and effect and determine whether retroactive application will further its purposes. *Id.*

The *Chevron* test is inapplicable to the present case since a ruling by the Court enforcing an agreement to arbitrate a § 12(2)

[36] *See also Gulf Offshore Co. v. Mobil Oil Corp.*, 453 U.S. 473, 486 n.16 (1981); *Thorpe v. Durham Housing Authority*, 393 U.S. 268, 281 (1969); *United States v. Schooner Peggy*, 1 Cranch 103, 110 (1801).

claim would not overrule clear past precedent on which petitioners could have justifiably relied. The Court's holding in *McMahon*, combined with its holdings in *Perry*, *Mitsubishi*, *Byrd*, *Keating*, *Cone* and *Scherk*, rejected the foundation of *Wilko* and cast substantial doubt on *Wilko*'s continued viability. The present case thus does not involve an issue of first impression whose resolution was not clearly foreshadowed. Secondly, such a decision will further the purposes underlying § 12(2) and the Arbitration Act and the rights afforded by § 12(2) will continue to be enforced in an arbitral, rather than in a judicial, forum. Lastly, since the arbitration agreement of the parties designates forums which the Court has ruled to be capable of protecting statutory rights, no substantial injustice or hardship will be inflicted upon petitioners through a retroactive application of the Court's decision. In fact, the Court's opinion in *McMahon* rendering § 10(b) and RICO claims arbitrable has already been applied retroactively requiring petitioners to arbitrate their claims asserted under these statutes against Shearson. Moreover, petitioners' § 12(2) claims are based on the same underlying facts as their § 10(b) and RICO claims.

The Court should adopt the ruling of the court of appeals which rejected petitioners' argument that the parties' agreement should not be enforced since they had no intent to agree to arbitrate § 12(2) claims at the time they entered into arbitration agreements with Shearson:

> We cannot conclude that appellees lacked the intent to agree to arbitrate because, at the time the customer agreements were signed, courts refused to honor clauses compelling arbitration of securities claims. At the same time the contracts were signed, the same circumstances existed barring arbitration of Exchange Act claims .... But appellees cannot now contend that they lacked the intent to arbitrate their Exchange Act claims in view of the Court's holding in *McMahon*. Neither the Supreme Court nor this Circuit considered the earlier lack of authoriztion to be an obstacle in *McMahon* .... or *Noble*. .... Both cases ordered arbitration of Exchange Act claims under analogous circumstances.

Rodriguez, 845 F. 2d at 1299.[37] Accordingly, a ruling by the Court that an agreement to arbitrate a § 12(2) claim is enforceable should be applied retroactively to the agreement of the parties in the present case.

[37] The lower federal courts have uniformly applied the Court's opinion in *McMahon* retroactively to enforce agreements to arbitrate § 10(b) and RICO claims after analyzing the *Chevron* test even though the courts held these claims nonarbitrable at the time the parties entered into their arbitration agreements. *See, e.g., Noble v. Drexel Burnham Lambert, Inc.*, 823 F. 2d 849, 850-51; *Ketchum v. Almahurst Bloodstock IV*, 685 F. Supp. 786, 789-90 (D. Kan. 1988).

CONCLUSION

Based on all of the foregoing reasons, the judgment of the United States Court of Appeals for the Fifth Circuit should be affirmed.

DATED: New York, New York
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Respectfully submitted,

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APPENDICES

APPENDIX A

STATUTES INVOLVED

United States Arbitration Act

9 U.S.C. § 2:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 3:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

Securities Act of 1933

Section 12(2), 15 U.S.C. § 77*l*(2):

> Any person who –
>
> * * *

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 14, 15 U.S.C. § 77n:

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

Section 22(a), 15 U.S.C. § 77v(a):

The district courts of the United States and United States court of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and

actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of Title 28. No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against it in the Supreme Court or such other courts.

Securities Exchange Act of 1934

Section 10(b), 15 U.S.C. § 78j(b):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

• • •

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 27, 15 U.S.C. § 78aa:

> The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts.

Section 29(a), 15 U.S.C. § 78 cc(a):

> Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule or an exchange required thereby shall be void.

APPENDIX B

District Court and State Court Cases Addressing the Enforceability of Agreements to Arbitrate Securities Act Claims Post-*McMahon*

A. Cases Holding Securities Act Claims Arbitrable Based on *McMahon*

Second Circuit

DeKuyper v. A. G. Edwards & Sons, Inc.,
695 F. Supp. 1367 (D. Conn. 1987), *aff'd upon reconsideration*,
N-85-529 (EBB) (D. Conn. Nov. 23, 1988)

Third Circuit

Kavouras v. Visual Products Systems, Inc.,
680 F. Supp. 205 (W.D. Pa. 1988)

Ryan v. Liss, Tenner & Goldberg Securities Corp.,
683 F. Supp. 480 (D.N.J. 1988)

Fifth Circuit

Baldwin v. Cowan & Company,
No. H-86-4247 (S.D. Tex. Jan. 19, 1988)

Rosenblum v. Drexel Burnham Lambert, Inc.,
[Current] Fed. Sec. L. Rep. (CCH) ¶ 94,031 (E.D. La. Aug. 19, 1987)

Seventh Circuit

Hallal v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,
No. 88 C 2405 (N.D. Ill. Dec. 13, 1988)

Ninth Circuit

Staiman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,
673 F. Supp. 1009 (C.D. Cal. 1987)

Tenth Circuit

Adams v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,
[1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,741 (W.D. Okla. Apr. 21, 1988)

Jeppsen v. Piper, Jaffrey & Hopwood, Inc.,
[Current] Fed. Sec. L. Rep. (CCH) ¶ 93,996 (D. Utah Aug. 16, 1988)

Reed v. Bear, Stearns & Co.,
[Current] Fed. Sec. L. Rep. (CCH) ¶ 94,126 (D. Kan. Aug. 19, 1988)

Simon v. Smith Barney, Harris Upham & Co., Inc.,
No. CIV-88-1124-T (W.D. Okla. Jan. 11, 1988)

Eleventh Circuit

Aronson v. Dean Witter Reynolds, Inc.,
675 F. Supp. 1324 (S.D. Fla. 1987)

Bender v. Prudential Bache Securities, Inc.,
No. 87-8572-CIV-ZLOCH (S.D. Fla. Mar. 14, 1988)

Benoay v. E.F. Hutton & Company,
No. 82-6709-Civ.-Paine (S.D. Fla. Jan. 8, 1988)

Guest v. Prudential-Bache Securities, Inc.,
No. 87-8942-CIV-ZLOCH (S.D. Fla. June 1, 1988)

Schuster v. Kidder, Peabody & Co.,
No. 86-6149-CIV-PAINE (S.D. Fla. 1988)

Sease v. PaineWebber, Inc.,
No. 87-1368-CIV-NESBITT (S.D. Fla. March 15, 1988)

Singer v. E.F. Hutton & Co.,
No. 87-6921-CIV-PAINE (S.D. Fla. 1988)

Yudelevich v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,
No. 87-1594-CIV-RYSKAMP (S.D. Fla. Mar. 16, 1988)

State Court Cases

Friedman v. E.F. Hutton & Co., No. CL88-10138-AP (Cir. Ct. Fla. Feb. 9, 1989)

Rocz v. Drexel Burnham Lambert, Inc.,
743 P.2d 971 (Ariz. App. 1987)

U.S. Optical Frame Co. v. Prudential-Bache Securities, Inc.,
No. 86-14071 (Cir. Ct. Fla. Sept. 28, 1987)

B. Cases Holding Securities Act Claims Nonarbitrable Based on *Wilko*

Second Circuit

McCowan v. Dean Witter Reynolds, Inc.,
682 F. Supp. 741 (S.D.N.Y. 1987)

Pompano-Windy City Partners Ltd. v. Bear, Stearns & Co.,
698 F. Supp. 504 (S.D.N.Y. 1988)

Third Circuit

Abadian v. Drexel Burnham Lambert, Inc.,
No. 88-0186 (E.D. Pa. Aug. 5, 1988) (LEXIS, Fedsec library, Courts file)

Ballay v. Legg Mason Wood Walker, Inc.,
No. 88-6867 (E.D. Pa. Dec. 21, 1988)

Helfricht v. Jefferies & Co.,
No. 85-0466 (D.N.J. Oct. 8, 1987) (LEXIS, Fedsec Library, Courts file)

McCullough v. Shearson Lehman Brothers, Inc.,
No. 86-2752 (W.D. Pa. Feb. 18, 1988) (LEXIS, Fedsec library, Courts file)

Sacco v. Prudential-Bache Securities, Inc.,
No. 88-6457 (E.D. Pa. Dec. 23, 1988)

Fifth Circuit

Continental Service Life & Health Ins., Co. v. A. G. Edwards & Sons, Inc., 664 F. Supp. 997 (M.D. La. 1987)

Seventh Circuit

Goldberg v. Drexel Burnham Lambert, Inc.,
No. 83 C 8586 (N.D. Ill. Dec. 16, 1987) (LEXIS, Fedsec library, Courts file)

Ninth Circuit

Three Valleys Municipal Water District v. E.F. Hutton & Co.,
No. CV-88-322 (PAR) (C.D. Cal. Dec. 30, 1988)

Tenth Circuit

Kaplan v. Prudential-Bache Securities, Inc.,
No. 87-F-777 (D. Colo. Oct. 12, 1987)

Ketchum v. Almahurst Bloodstock IV,
685 F. Supp. 786 (D. Kan. Feb. 12, 1988)

Eleventh Circuit

Araim v. PaineWebber, Inc.,
691 F. Supp. 1415 (N.D. Ga. 1988)

Schultz v. Robinson-Humphrey/American Express, Inc.,
666 F. Supp. 219 (M.D. Ga. 1987)

State Court Case

Johnson v. Dain Bosworth, Inc., [1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,758 (Minn. Ct. App. Mar. 15, 1988), *review denied*, No. C9-87-1784 slip op. (Minn. Sup. Ct. May 18, 1988), *petition for cert. filed*, 57 U.S.L.W. 3161 (U.S. Aug. 12, 1988) (No. 88-284).

Supreme Court, U.S.
FILED
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No. 88-385

In The

Supreme Court of the United States

October Term, 1988

OFELIA RODRIGUEZ de QUIJAS, ET AL,

Petitioners,

vs.

SHEARSON/AMERICAN EXPRESS, INC. ITS SUCCESSORS AND ASSIGNS,

Respondents.

REPLY BRIEF OF PETITIONERS

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March 17, 1989

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QUESTIONS PRESENTED

1. Are claims under Section 12(2) of the 1933 Securities Act now arbitrable under predispute broker contracts?

2. If such claims are now arbitrable, may these Petitioners be compelled to submit such claims to arbitration pursuant to terms of a predispute contract executed at a time when Section 12(2) claims were clearly not subject to arbitration?

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ARGUMENT

1. As Determined By This Court In *Wilko*, The Intent Of The 1933 Securities Act Was To Void All Compulsory Predispute Arbitration Agreements Concerning Section 12(2) Public Customer Complaints

Neither the intent of the 73rd Congress nor the views of the seven justices of the *Wilko* Court[1] can be changed,

[1] See, L. Loss, *Fundamentals of Securities Regulation*, (1983) at 1193, where Professor Loss noted that *Wilko* " . . . presented a neat conflict between two socially desirable policies – arbitration with its advantages of speed and economy, and protection of the rights of investors against persons with superior bargaining power." The determination made by the *Wilko* court to negate arbitration was, according to Loss, "eminently sensible". Id. at 1193

both of which acts Respondent would attribute to the *McMahon* majority opinion. *McMahon* was not a Section 12(2) case and despite the language quoted by Respondent (Brief at 11-2), *McMahon*, like all cases from *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974), on forward, endorses the thesis that every federal statute must be independently examined vis a vis the question of negation of the FAA's applicability. That is, of course, precisely what Respondent argued to this Court in *McMahon*.[2]

Moreover, the *McMahon* logic is itself flawed and even advocates of arbitration in other contexts assail that decision. One such advocate, Professor Carbonneau, has, with unusual candor, very recently written of *McMahon*:

> Both the end achieved and the means employed . . . indicate that the Court will to practically any length to uphold arbitration agreements, *McMahon* makes it abundantly clear that the Court is impelled by an unbending objective: fostering the unfettered recourse to arbitration. In effect, the Court's desire to eliminate all vestiges of judicial hostility toward arbitration has given arbitration a privileged position in the cosmology of protected judicial values. Indeed, following *McMahon*, it is not all implausible that the consideration afforded arbitration is not so different, in kind or in degree, from the constitutional regard given to political speech, racial equality, or other fundamental values or rights. The uncompromising tenor of the doctrine generates questions about the wisdom and motivation for the Court's stance . . .
>
> . . . to achieve the objective of declaring that both Exchange Act and RICO claims are arbitrable, the

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[2] Brief of Petitioners On The Merits, *Shearson/American Express, Inc. v. McMahon*, No. 86-44 at 12, 14.

> Court engages in an uncharacteristic and disappointing display of narrow, strained, and distortive construction of statutes and prior decisional law. While the Court's aim of eliminating any restrictions on arbitration is transparent, its methodology and doctrine are confusing, unpersuasive, and ultimately unsound . . .
>
> The reasoning in *McMahon* suffers from several methodolical and conceptual difficulties. As to the issue of the arbitrability of Exchange Act claims . . . the majority opinion begins by incanting the now-consecrated view that a claim based upon statutorily-conferred rights does not disrupt the ordinarily "hospitable" inquiry into the question of arbitrability. To defeat the implied presumption favoring the arbitrability of claims, the statute that is the vehicle for creating the rights must contain, in either its language or its legislative history, a congressional command mandating exclusive recourse to the courts for the vindication of claims. Moreover, the burden is upon the party opposing arbitration to establish the existence of such congressional intent. Having weighted the inquiry in favor of a finding of arbitrability the majority opinion then engages in a series of strained constructions to guarantee the result implied by its initial proposition . . .
>
> . . . the Court advances a painfully technical interpretation of the Exchange Act arguing that the non-waiver language of the Act applies exclusively to the substantive obligations under the legislation. Since the recourse to arbitration merely represents the selection of a different forum and remedial process, such an agreement – the Court would have us believe – has no impact upon the substantive statutory rights in question . . .
>
> The Court, however, attributes no significance whatever either to the underlying purpose of the Exchange Act (to protect individual investors from overreaching by securities industry professionals) or

to the intractable reality that arbitrators are likely to construe the applicable law very differently from judges, especially in light of the fact that the arbitral procedure in these circumstances is established and directed by the securities industry. In effect, the Court chooses to ignore the adhesionary character of the contract and the arbitration agreement, neglecting the evident need for consumer protection generated by the facts. The Court exhibits similarly tendentious and distortive reasoning in its attempt to align the result in *McMahon* with the principles of prior decisional law on arbitration. . . .

For example, the majority opinion interprets the *Wilko* decision as barring the selection of a non-judicial forum where arbitration is inadequate to protect the substantive rights at issue. . . .

In effect, *Wilko* stands for a very different proposition . . . According to the express language of *Wilko*, as between two competing congressional policies – upholding arbitration . . . and protecting securities investors . . . the *Wilko* Court gave effect to the latter in light of the express statutory language in the 1933 Act providing for exclusive judicial remedies and relief. [footnotes omitted][3]

2. The 1933 Act Expressly Prohibits Waiver Of "Any Provision" And Not "Substantive Duties"

Respondent (Brief at 12, 14) structures its argument around what it calls "substantive duties," however, Section 14 of the 1933 Act provides, in clear, unambiguous language, that investors may not be compelled to waive

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[3] T.E. Carbonneau, *American And Other National Variations on The Theme of International Commercial Arbitration*, 18 Ga. J. of Int'l & Comp. L. 143, 224-229 (1988).

compliance with any *provision*. There is no reference to "substantive duties."[4] The entire notion of substance versus procedure, seen throughout the *McMahon* majority opinion, is textually and historically insupportable. Neither the Act itself nor any dictionary defines "provision" as "substantive duty" nor does the *Wilko* opinion admit of any such definition. As one court has noted, "As applied to legislation, the word 'provision' has this well-understood meaning: 'actual expression in language' – the clothing of legislative ideas in words which can be pointed out upon the page, and read with the eye." *State v. Lund*, 67 S.W. 572, 576 (1902).

Section 22(a) of the Securities Act implements the *in terrorem* civil provisions of the 1933 Securities Act, providing that federal and state courts shall have concurrent jurisdiction "of all suits in equity and actions at law," and providing for mandatory venue. The section further negates removal jurisdiction. If Congress had intended that Securities Act claims be arbitrated, then surely the reasonable argument to be made is that why then was *arbitration* not specifically referred to in Section 22 and *its* venue proscribed? The entire section was, after all, preceded by the heading "Jurisdiction", a term whose meaning and legal import are well appreciated in other contexts.

The legislative history of the 1933 Act clearly provides the answer. Those who breach the 1933 Act's fiduciary duties are to answer for such violations in a court of

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[4] For the view that the burden of proof of a fiduciary in a fraud action is a matter of substance, see *Vance v. Guy*, 31 S.E.2d 766 (1944) and *Fitzsimmons v. Frey*, 43 N.E.2d 531 (1950). On such view, realities of arbitration can be viewed as negating the equivalent 12(2) right.

law. A nation had finally had enough. Slippery, slick-talking salesmen and corporate carpetbaggers were at long last going to face the music in a *court of the investor's choice*. Section 14's non-waiver provisions were a clear recognition by this nation's 73rd Congress that those whose glib tongues had enabled them to sell the most outrageous investment schemes to the American public, would be expected to attempt to extract from the investing public, every right created by the 1933 Act.[5]

Respondent's adhesion contract slight of hand, which flaunted SEC Rule 15c2-2 (and effectively this Court's *Wilko* instruction) is, sadly, in the historically predatory tradition of the securuties industry. Petitioners have already purchased Respondents' false investment promises with their life savings and, apparently unlike the majority in *McMahon*, have a hardened perspective which exposes the stock of industry arbitration for what is – the last opportunity to avoid the consequences of fraudulent acts prohibited by the 1933 Act, the last opportunity, as it were, to cheat.[6]

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[5] Nor does the FAA, if one acknowledges the apparent intent of Section 2's savings clause, evidence any intent to negate the distributive justice role that courts play in American jurisprudence, which, as one author has noted, is the effect of the holding in *Mitsubishi Motors Corp. v. Soler-Chrysler Plymouth*, 473 U.S. 614 (1985) and which is the logical eqivalent of granting to private parties the right to assess and collect taxes. See Morgan, *Contract Theory and the Sources of Rights: An Approach to the Arbitrability Question*, 60 S. Cal. L. Rev. 1059 at 1081-82.

[6] See Appendix A for an insider's reve'ation of how that is accomplished in the NASD where investors have the "option" of choosing arbitrators from a hand-picked corps of individuals who have already been carefully pre-screened by the NASD on the basis of proven pro-industry bias.

3. Any SEC Role Is Not Relevant To The Arbitrability Of 1933 Act Claims

While Petitioners believe that the historical role of the SEC in preventing securities fraud has been less than exemplary, has lessened during the Reagan administration,[7] and has been typified by the non-enforcement of SEC Rule 15c2-2, there is no textual relevance to SEC oversight in the 1933 Act since the 1933 Act contains no reference to any customer arbitration proceeding, and, as held by the seven justices in *Wilko*, the intent of the 1933 Act was to invalidate predispute arbitration agreements.[8] Petitioners emphasize, again, that the problems relevant to arbitration of 1933 Act claims are inherent and intractable. Whatever alterations are ultimately mandated by the SEC, those cannot rewrite the 1933 Act (nor in Petitioners' view, could they ever provide a fair forum in which to hold those dealing with "other people's" money fully accountable).[9]

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[7] "The SEC's reversal [in *McMahon*] can be seen as an aspect of its generally deregulatory mood under President Reagan and Chairman Shad . . . " Bromberg & Lowenfels, *Securities Fraud And Commodities Fraud*, Vol. 6, NM:46.1 (1988).

[8] Petitioners further note that the SEC has not filed an amicus brief here nor requested participation in oral argument.

[9] The Brief of the Securities Industry Association in Support of Respondants, *Rodriguez v. Shearson/American Express*, No. 88-385, submits an *unaudited, three-month* study which omits "one isolated case . . . because it was considered to bias the remainder of the sample" to show (apparently) that arbitration is, in terms of comparative *result*, fair. Id. at A-22 through A-26.

4. The Legislative History Of The 1975 Amendments To The Exchange Act Which Specifically Endorse *Wilko* Together With 35 Years Of Congressional Acquiescence Cannot Be Explained Away As The Congressional Intent Of "Leaving The *Wilko* Issue To The Courts"

The *McMahon* view of the 1975 Exchange Act amendments as not constituting an endorsement of non-arbitrability of Exchange Act claims, is a strained view, and any extension of such view in an attempt to negate the 1975 Exchange Act's Amendment history as an endorsement of *Wilko*, per se, vis a vis the 1933 Act's non-arbitrability of 12(2) public customer claims, tests the limits of reasonable construction.

5. Stare Decisis Should Be Adhered To for Institutional Reasons

Apart from basic jurisprudential reasons for adhering to *Wilko*, as advanced heretobefore by Petitioners, there is an additional, significant institutional reason for preserving such precedent. Unlike the vast majority of prior decisions of this Court wherein precedents have been overruled, a destruction of *Wilko* would raise a clear self-interest suspicion since the effect of a change in *Wilko* would, in light of the judicial and extra-judicial rhetoric of this Court that arbitration will reduce the burden on the nation's court system,[10] suggests self-interest. In the

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[10] See, for example, Burger, *Isn't There A Better Way?* 68 A.B.A. J. 274-75 (1982). This self-interest suspicion is amplified where, as here, the precedent is *regulatory* in nature (parties can adjust their voluntary acts to conform to the precedent) as

(Continued on following page)

context of the federal courts, whose judges are appointed for life, that self-interest suspicion is substantial and represents a potential loss far exceeding any hoped-for administrative gain.

6. Retroactivity Of Any *Wilko* Change Would Be Manifestly Unjust

The historical record is clear: Until *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985), there was no hint that any public customer fraud case under the 1933 Act could be subjected to compulsory arbitration via a predispute agreement purporting to effect that result and retroactive application of any change to *Wilko's* view of the non-arbitrability of 1933 Act claims arising under documents signed in 1982 and 1983 would be shockingly unjust and inconsistent with all of this Court's relevant precedents, including those cited by Respondents..

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opposed to *remedial* (where the victim is not capable of adjusting the actor's conduct). In the first situation there is reliance on the precedent, in the second, no reliance – at least by the victim.

APPENDIX "A"

LAW OFFICES

BURNHILL, MOREHOUSE, BURFORD, SCHOFIELD & SCHILLER

A PROFESSIONAL CORPORATION

September 6, 1988

Steven Swartz
Business Editor
Wall Street Journal
200 Liberty Street
New York, N.Y. 10281

RE: NASD ARBITRATIONS

Dear Mr. Swartz:

This letter is written with reference to how the National Association of Securities Dealers (NASD) is handling securities cases that are mandated to arbitration after the Supreme Court decision in *Shearson v. McMahon*, 107 Supreme Ct. Rptr. 2332, 96 L.Ed.2d 185. Under the holding of *Shearson*, supra, pre-dispute arbitration agreements are enforceable to compel arbitration of a claim arising under the Exchange Act. I previously worked for the NASD as an arbitration administrator. I was able to observe first hand how the NASD procedures work relative to arbitration claims brought by customers of broker-dealers against member firms.

As an attorney with business and securities experience and academic training as an M.B.A. and C.P.A., I am well able to offer comments on how the arbitration process works at the NASD.

It is stated by Justice Blackmun in his dissenting opinion in the *Shearson* case, that the investor has the impression, frequently justified, that his claims are being judged by a forum composed of individuals sympathetic to the securities industry and not drawn from the public. Further, Justice Blackmun cites Sheldon Elsen, Chairman of the American Bar Association, with the quote that, "The houses basically like the present system because they own the stacked deck."

In my opinion, if a claimant goes before the NASD in seeking recompense for alleged violations by brokers, there is a minimal chance of a fair hearing. In arbitration procedures, there is no right to appeal and there is a bias in the panel selection.

In particular, bias is noted in the panel selections. Panel selections are not carried out in accordance with the guidelines set forth by the Securities and Exchange Commission. In fact, arbitrators who ultimately become panel members, are ranked in a subjective manner based on a numerical rating assigned by the NASD West Coast Head of Arbitrations. If an arbitrator ranks low in the opinion of the Chief of NASD Arbitrations, then that person is not used at all in futur arbitrations. After each arbitration, the arbitrators are again subjectively rated by the NASD Arbitration staff and comments are made in writing to the respective arbitrator's file. Those arbitrators who are deemed less than average, on strictly a subjective basis, are not used again. What the subjective rankings result in is a narrowing of the arbitrators from a large qualified pool to one which is deemed acceptable by standards known only to the NASD. A review of the files

of the NASD would indicate that the arbitrators deemed acceptable are used over and over again.

Further, attorneys who have represented claimants against broker-dealers and who are also qualified as NASD arbitrators, are automatically not selected as arbitrators. The NASD is highly arbitrary in their selection process, leaving little room for a random selection basis as in judge selection, rather than a subjective orientation based on the opinions of the staff of the NASD.

As to the arbitration proceedings themselves, I have sat in on numerous cases and have seen that the arbitrators read very little of the material that complainants or respondents present. The decision making process can be characterized as none other than making snap judgments without weighing detailed factual information of a substantial nature. Discovery is in most cases minimal in nature. There are no written opinions by the arbitrators and no right of appeal. This arbitrary and undocumented process puts the customer at a disadvantage relative to the broker-dealer.

Moreover, arbitrators are typically not knowledgeable in securities law to in effect render a determination as to whether fraud or misrepresentation, have taken place. It should be pointed out that tin a small number of cases, the errors of brokers are so egregious, that fraud or misrepresentation can clearly be identified by the panel members selected.

Brokerage firms can put a lot of pressure on brokers if brokers serving as arbitrators are deciding a number of adverse opinions of large amounts against their own brokerage firms or other firms in the industry. That is, the

arbitration procedures are fraught with conflicts of interest and it is doubtful in my opinion whether the statutory rights of customers can be enforced against broker-dealers in the arbitration forum.

In summary, I find particularly egregious that (1) the arbitrator selection tends to be very haphazard and subjective; (2) the arbitrators do not have sufficient legal background to make the decisions necessary in the vast majority of cases; (3) the forums are rife with conflicts of interest; and (4) the forum itself is biased based on the procedures involved. This letter and any other comments I make can be the subject of a general article relating how the NASD arbitrations work today.

While *Shearson* mandated enforcement of pre-dispute arbitration clauses, it did so with the understanding that the arbitration process was efficient and fair. In practice, the process is far from it. In my opinion, the forum should be modified to use arbitrators who are outside the industry, and in particular, to use lawyers that are independent. Thank you for you time and attention. Please call me if you have any questions relating to this letter. My business telephone number is (415) 937-4950.

Very truly yours,

THOMAS P. HOGAN

TPH:sw

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COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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B. Survey Taken by Deloitte Haskins & Sells at the Request of the New York Stock Exchange, Inc., of Arbitration and Litigation Results of Customer Disputes with Six Brokerage Firms During a 3-month Period in 1987 and 1988, transmitted by the New York Stock Exchange to the Securities and Exchange Commission on October 17, 1988, and also filed with the United States District Court for the District of Massachusetts in *Securities Industry Association* v. *Connolly*, Civil Action No. 88-2153-WD, and attached as an Exhibit to the Affidavit of Paul J. Dubow, Sworn to November 28, 1988..... A-22

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Survey Taken by Deloitte Haskins & Sells at the Request of the New York Stock Exchange, Inc., of Arbitration and Litigation Results of Customer Disputes with Six Brokerage Firms During a 3-Month Period in 1987 and 1988 (Appendix B to this Brief) 12-13, 13n

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-385

OFELIA RODRIGUEZ DE QUIJAS, *et al.*,

Petitioners,

—v.—

SHEARSON/AMERICAN EXPRESS, INC.,
its successors and assigns,

Respondents.

BRIEF OF *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

PRELIMINARY STATEMENT

The Securities Industry Association ("SIA"), D.A. Davidson & Co., Inc. ("D.A. Davidson"), Dain Bosworth Incorporated ("Dain Bosworth"), Dean Witter Reynolds Inc. ("Dean Witter"), Goldman, Sachs & Co. ("Goldman"), J.C. Bradford & Co. ("J.C. Bradford"), J.J.B. Hilliard, W.L. Lyons, Inc. ("Hilliard Lyons"), Johnston, Lemon & Co. Inc. ("Johnston Lemon"), Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), Piper, Jaffray & Hopwood Inc. ("Piper Jaffray"), The Advest Group, Inc. ("Advest"), and Wheat, First Securities, Inc. ("Wheat First"), submit this brief as *amici curiae* in support of respondents, and urge this Court to affirm the opinion and judgment of the United States Court of Appeals for the Fifth Circuit below in *Rodriguez de Quijas* v. *Shearson/Lehman Brothers*, 845 F.2d 1296 (5th Cir. 1988). The consents of petitioner Ofelia Rodriguez de Quijas and of

respondent Shearson/American Express, Inc., have been obtained and the originals thereof have been filed with the Clerk of the Court.

INTEREST OF *AMICI CURIAE*

SIA is the principal trade association of the securities industry, having as members more than five hundred and fifty securities firms in the United States and Canada. As such, it has a substantial interest in the extent to which agreements to arbitrate claims between securities firms and their customers may be enforced. Because arbitration is an efficient, fair, and economical manner of resolving disputes, most of SIA's members have agreed with many of their customers to arbitrate any controversies arising between them. Among these members are *amici* Advest, D.A. Davidson, Dain Bosworth, Dean Witter, Goldman, Hilliard Lyons, J.C. Bradford, Johnston Lemon, Merrill Lynch, Piper Jaffray, and Wheat First.

Certain *amici* are parties to cases pending in the lower federal courts that involve the issue presented on this petition. The procedural outcome of those actions will be affected by any decision taken by this Court on this petition. *Amici* therefore have a substantial interest in seeing this Court resolve whether agreements to arbitrate claims arising under Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2) (the "Securities Act"), are enforceable as valid contracts under Section 2 of the United States Arbitration Act, 9 U.S.C. § 2 (the "Arbitration Act"), as is the case with claims arising under the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.* (the "Exchange Act"). *Amici* seek to clarify and make uniform the law on this issue so that the enforceability of arbitration provisions in agreements with their customers can be predicted and relied upon. SIA and certain *amici* also filed briefs *amicus curiae* with this Court on the enforceability of agreements to arbitrate Exchange Act claims in *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. 213 (1985), and in *Shearson/American Express, Inc.* v. *McMahon*, 482 U.S. 220, 107 S. Ct. 2332 (1987), and moved for leave to file a brief with respect to a petition raising the identical issue in *Dain Bosworth Incorporated* v. *Johnson*, No. 88-284.

SUMMARY OF ARGUMENT

The issue before the Court is whether predispute agreements to arbitrate claims arising under Section 12(2) of the Securities Act, 15 U.S.C. § 77*l*(2) are enforceable. In *Shearson/American Express, Inc.* v. *McMahon*, 482 U.S. 220, 107 S. Ct. 2332 (1987), the Court held that agreements to arbitrate claims under Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), were enforceable under the Arbitration Act.

McMahon rejected an argument based on *Wilko* v. *Swan*, 346 U.S. 427 (1953), that a predispute agreement to arbitrate securities claims waives substantive rights under the federal securities laws. *Wilko* held that an agreement to arbitrate Section 12(2) claims waives substantive rights bestowed by the Securities Act and that Section 14 of the Act, 15 U.S.C. § 77n, which voids any waiver of compliance with that Act, therefore voids such agreements to arbitrate. Yet the Court subsequently held in *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), that, by agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute under which the claim arose. Following *Mitsubishi*, the Court in *McMahon* found that arbitration as practiced in the securities industry today offers a fair and efficient means of resolving disputes and that an agreement to arbitrate securities disputes does *not* waive substantive rights under the Exchange Act. *McMahon* thus disavowed both *Wilko*'s general hostility to the arbitration process and its specific reasoning.

In light of *McMahon*, the United States Court of Appeals for the Fifth Circuit below held that predispute agreements to arbitrate Section 12(2) claims are enforceable under the Arbitration Act. *Rodriguez de Quijas* v. *Shearson/Lehman Brothers*, 845 F.2d 1296 (5th Cir. 1988). Because *McMahon* rejected the analytical predicate of the decision in *Wilko*—that an agreement to

arbitrate waives substantive rights—the Fifth Circuit interpreted *McMahon* as having effectively overruled *Wilko* and therefore did not feel constrained to follow *Wilko*.

The Fifth Circuit below correctly recognized *Wilko*'s "obsolescence" in light of the *McMahon* decision. *Wilko* reflects the suspicion courts once held of the arbitral process, as opposed to the congressionally enacted federal policy recognizing arbitration as an efficient means of resolving disputes. *See Shearson/American Express, Inc.* v. *McMahon*, 107 S. Ct. at 2340; *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*; *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984); *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U.S. 1 (1983). *Wilko* did not apply the correct standard for determining whether Section 12(2) repealed the Arbitration Act by implication, a standard this Court has reiterated in *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. 72 (1982), and *Morton* v. *Mancari*, 417 U.S. 535 (1974). Rather than searching for statutory language in the Securities Act conflicting with the Arbitration Act or legislative history indicating congressional intent to repeal the Arbitration Act, *Wilko* overruled the substantive, congressional policies embodied in the Arbitration Act solely on the basis of its own conception of public policy.

Amici respectfully submit that, given the fairness and efficiency of arbitration in the securities industry, as found in *McMahon*, the Court should have no hesitation in holding a predispute agreement to arbitrate Section 12(2) claims as enforceable as any other contract. That result would make the law uniform for all agreements to arbitrate securities claims and conform to the well settled rule as to the enforceability of arbitration agreements in general. *See Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*

POINT I

THE UNITED STATES ARBITRATION ACT MANDATES THAT ARBITRATION BE RECOGNIZED AS AN EFFICIENT AND WIDELY ACCEPTED MEANS OF RESOLVING BROKER-CUSTOMER DISPUTES IN THE SECURITIES INDUSTRY

The United States Arbitration Act provides that an agreement to arbitrate in a contract involving interstate commerce is valid to the same extent as any other contract. When Congress passed the Arbitration Act in 1925, it established a clear federal policy favoring the use of arbitration to resolve disputes. That policy marked a decisive shift from the hostility to arbitration then prevalent in the courts.

In its recent decisions, this Court has found occasion to recognize the policy behind the Arbitration Act. In *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, the Court observed:

> [W]e are well past the time when judicial suspicion of the desirability of arbitration and the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.

473 U.S. at 626-27. *Accord Moses H. Cone Memorial Hospital* v. *Mercury Constr. Corp.*, 460 U.S. at 24 (the Arbitration Act "is a congressional declaration of a liberal federal policy favoring arbitration . . . [and] questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration"); *Southland Corp.* v. *Keating*, 465 U.S. at 10 (in passing the Arbitration Act, "Congress declared a national policy favoring arbitration . . . [that] mandated the enforcement of arbitration agreements"); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-11 (1974); *see also Wilko* v. *Swan*, 346 U.S. at 439 Frankfurter, J., dissenting) ("[t]here is nothing in the record . . . to indicated that the arbitral system . . . would not afford the plaintiff the rights to which he is entitled").

Since this Court has decisively abandoned both the analytical reasoning and the deep suspicion of arbitration that permeates the opinion in *Wilko* v. *Swan*, there is no reason that *Wilko* should hold sway even in the narrow space to which it is now restricted. *Wilko* is premised on a fundamental hostility to arbitration. *See Shearson/American Express, Inc.* v. *McMahon*, 107 S. Ct. at 2340. Proceeding from that premise, *Wilko* espoused the theory that an agreement to arbitrate Securities Act controversies waives substantive rights under that statute. Because Section 14 of the Securities Act, 15 U.S.C. § 77n, invalidates "any . . . stipulation . . . to waive compliance with any provision" of the Securities Act, and because the Court doubted that arbitration panels would adequately enforce compliance with that Act, it therefore found predispute agreements to arbitrate Section 12(2) claims void.[1]

The decision in *Wilko* flatly ignored the substantive federal policy embodied in the Arbitration Act. In equating an agreement to arbitrate Securities Act controversies with a waiver of compliance with that Act, *Wilko* put the blind eye to Congress's unmistakable mandate that arbitration was to be a respected method of resolving disputes and that there was no public policy against agreements to arbitrate.

As this Court has recognized, its recent decisions substantially differ from *Wilko*'s hostility to arbitration. For example, *McMahon* observed:

1 *Wilko*'s language shows extraordinary cynicism as to the competence of arbitration tribunals:

> [A Securities Act] case requires subjective findings on the purpose and knowledge of an alleged violator of the Act. They must not only be determined but applied by the arbitrators without judicial instruction on the law. As their award may be made without explanation of their reasons and without a complete record of their proceedings, the arbitrators' conception of the legal meaning of such statutory requirements as "burden of proof," "reasonable care" or "material fact" . . . cannot be examined.

346 U.S. at 435-36.

> It is difficult to reconcile *Wilko*'s mistrust of the arbitral process with this Court's subsequent decisions involving the Arbitration Act.

107 S. Ct. at 2341. Moreover, this Court has twice rejected the predicate of the *Wilko* decision, the notion that an agreement to arbitrate controversies under a federal statute waives compliance with the provisions of that statute:

> By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits their resolution to an arbitral, rather than judicial forum. It trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.

Mitsubishi Motors Corp. v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. at 628; *accord*, *Shearson/American Express, Inc.* v. *McMahon*, 107 S. Ct. at 2339.[2]

Not only did *McMahon* abandon *Wilko*'s reasoning, it reached the exact opposite holding: it held that an agreement to arbitrate claims arising under Section 10(b) of the Exchange Act was *not* a "stipulation . . . to waive compliance with" the Exchange Act, which is void under Section 29(a) of that Act, 15 U.S.C. § 78cc(a), whereas *Wilko* had held that such an agreement *was* a "stipulation . . . to waive compliance with" the

2 The fallacy in *Wilko*'s confusion between a forum selection clause and a waiver of substantive rights is manifested in *Johnson* v. *O'Brien*, 420 N.W.2d 264 (Minn. App. 1988), *review denied*, No. C9-97-1784 slip op. (Minn. May 18, 1988), *petition for cert. filed sub nom. Dain Bosworth Incorporated* v. *Johnson*, No. 88-246. The plaintiffs in *Johnson* brought suit in state court, foregoing any procedural safeguards offered by the federal courts. Because the Securities Act vests both the state and federal courts with jurisdiction to hear Securities Act claims, an agreement requiring that all Securities Act claims be brought in a particular state court would not waive compliance with the Securities Act under Section 14. Yet there is nothing that ensures that a state court will provide a more advantageous forum for Securities Act claims than arbitration. To the contrary, the stock exchanges' powers to compel the presence of registered persons at arbitrations, for example, can far exceed that of state courts. *See* note 16, *infra*, at 12.

Securities Act. Yet, although *McMahon* questioned *Wilko*'s continuing vitality ("indeed most of the reasons given in *Wilko* have been rejected subsequently by the Court as a basis for holding claims to be nonarbitrable"), it nonetheless cautioned that "*stare decisis* concerns may counsel against upsetting *Wilko*'s contrary conclusion under the Securities Act." 107 S. Ct. at 2341.

Wilko's inconsistency with the state of arbitration in the securities industry today not only explains but justifies this Court's reluctance to follow *Wilko*'s holding or its policy pronouncements. The established structure of arbitration in the securities industry refutes *Wilko*'s assumption that the enforcement of contracts to arbitrate securities disputes will dilute the protection of investors under the securities laws. Securities exchanges and the National Association of Securities Dealers, Inc. (the "N.A.S.D."), under the supervision of the Securities and Exchange Commission, provide arbitration facilities for disputes between member firms and their public customers.[3] The current procedures have evolved since 1872, when the New York Stock Exchange, Inc. (the "N.Y.S.E."), first conducted customer arbitrations. The N.A.S.D. has maintained arbitration facilities for more than forty years. The exchanges and the N.A.S.D. also have permanent arbitration staffs. Their rules and constitutions contain detailed codes of arbitration procedures.[4]

Moreover, the Securities and Exchange Commission has approved the implementation and operation of this arbitral system, *see* Exchange Act Release No. 16390 (S.E.C. Nov. 30,

3 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542 (Rule 602); N.A.S.D. Manual (CCH) ¶ 3701; 2 N.Y.S.E. Guide (CCH) ¶ 2600 (Rule 600); Uniform Code of Arbitration § 1, *reprinted in* Fifth Report of the Securities Industry Conference on Arbitration (April 1986).

4 *See, e.g.*, Constitution of the New York Stock Exchange, Inc., Art. VIII, 2 N.Y.S.E. Guide (CCH) ¶¶ 1351-1357; Rules 600-634 of the New York Stock Exchange, Inc., *id.* ¶¶ 2600-2634; Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., N.A.S.D. Manual (CCH) ¶¶ 3701-3743; Arbitration Rules of the American Stock Exchange, Inc., 2 Am. Stock Ex. Guide (CCH) ¶¶ 9540-9551J.

1979), 18 S.E.C. Docket 1197 (1979), and retains jurisdiction to monitor the fairness of arbitration proceedings. *See* Section 19 of the Exchange Act, 15 U.S.C. § 78s. As the Commission itself argued to this Court in *McMahon*, in a brief signed by its General Counsel and Solicitor:

> [T]he Commission has had the power to ensure that arbitration procedures prescribed by the SROs [Self-Regulatory Organizations] are adequate to enforce the rights of customers against brokerage firms that are members of SROs. In these circumstances, the suspicion of arbitration on which *Wilko* rested is inappropriate, and an agreement to arbitrate accordingly should not be deemed a waiver of rights under the Exchange Act.

Shearson/American Express, Inc. v. *McMahon*, No. 86-44, Brief of the Securities and Exchange Commission as *amicus curiae* at 13.

That the Securities Industry Conference on Arbitration ("SICA") and the Commission have worked together to add further improvements to SRO arbitration codes in the year following the *McMahon* decision proves that the Commission can and will exercise its oversight authority and that SROs will respond in a constructive manner. During the Summer of 1988, the Commission invited SICA and the stock exchanges to review and possibly revise their arbitration rules in certain respects. SICA and the stock exchanges considered the matter and drafted amendments to their arbitration rules, which they have filed with the Commission pursuant to Exchange Act Rule 19b-4, 17 C.F.R. § 240.19b-4.[5]

As changed, the rules would require that any arbitration clause in a broker-customer agreement be highlighted and in plain language. In addition, the arbitration clause must disclose to the customer that he is thereby foregoing a jury trial in any lawsuit against his broker and agreeing to limits on discovery

5 The N.Y.S.E.'s proposed rule changes, which are substantively identical with SICA's and were filed with the Commission on October 17, 1988, File No. SR-NYSE-88-29, are set forth as Appendix A to this brief.

and appellate review.[6] The contract must also disclose the presence of the arbitration clause immediately before the customer's signature line.[7] The proposed amendments further require that discovery requests be responded to within 30 days and provide for a prehearing conference before an arbitration panel to resolve discovery disputes.[8] Retired securities industry personnel (as well as professionals who do substantial business with securities firms) who serve as arbitrators may only serve as industry arbitrators, and all arbitrators must provide their employment history for the prior ten years to the parties.[9] Last, a record, either stenographic or taped, must be kept of all arbitration proceedings, and arbitration awards must state the issue involved, the amount claimed, and the amount actually awarded.[10]

The long established competence of securities industry arbitrators to adjudicate disputes should dispel any suspicion of the arbitral process in that industry. The stock exchanges and the N.A.S.D. keep permanent lists of arbitrators. These lists comprise senior securities industry personnel, attorneys, and other professionals from outside the industry, who are well versed in the field. *See, e.g.*, Panel of Arbitrators 1988-89, 1 Am. Stock Ex. Guide (CCH) 158-59; N.A.S.D. Manual (CCH) ¶ 3702. Most have previously served as arbitrators and are therefore well acquainted with arbitration procedures and customs. Thus, this Court's observation in *Mitsubishi* that "adaptability and access to expertise are hallmarks of arbitration," 473 U.S. at 633, hits the mark with respect to the securities industry. As this Court stated after reviewing the state of arbitration in the securities industry in *McMahon*, "Even if *Wilko*'s assumptions regarding arbitration were valid at the time *Wilko* was decided,

6 *See* Appendix A, Proposed N.Y.S.E. Rule 637(1), at A-19.

7 *See* Appendix A, Proposed N.Y.S.E. Rule 637(2), at A-19.

8 *See* Appendix A, Proposed Rule 619(a)(b)(2), (d) at A-12-13.

9 *See* Appendix A, Proposed N.Y.S.E. Rule 610, at A-6-7.

10 *See* Appendix A, Proposed N.Y.S.E. Rules 623 and 627, at A-15-16.

most certainly they do not hold true today. . . ." 107 S. Ct. at 2341.[11]

The arbitration rules of the N.A.S.D. and the various securities exchanges further ensure that arbitration practice in the securities industry will be efficient and impartial. For example, these rules require that panels of arbitrators include members of the securities industry and of the public.[12] They require a majority of "public" arbitrators (*i.e.*, unaffiliated with member firms) in disputes between public customers and member firms unless the customer requests otherwise.[13] Arbitrators are required to disclose any business affiliation with any parties before them, and may be disqualified for cause for even the

11 Far from considering themselves as the only tribunal capable of hearing securities disputes, the federal courts have recognized securities industry arbitrators as qualified to resolve those claims. Courts have long compelled arbitration of Exchange Act disputes between members of a securities exchange or the N.A.S.D. *See, e.g., Shearson/American Express, Inc. v. McMahon*, 107 S. Ct. 2332; *Axelrod & Co.* v. *Kordich, Victor & Neufeld*, 320 F. Supp. 193 (S.D.N.Y. 1970), *aff'd*, 451 F.2d 838 (2d Cir. 1971); *Brown* v. *Gilligan, Will & Co.*, 287 F. Supp. 766, 774-75 (S.D.N.Y. 1968). Claims under the Exchange Act are routinely arbitrated if the public customer chooses to arbitrate. *See Gardner* v. *Shearson, Hammill & Co.*, 433 F.2d 367 (5th Cir. 1970) (*per curiam*), *cert. denied*, 401 U.S. 978 (1971); *Moran* v. *Paine, Webber, Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968); *cf. AVC Nederland B.V.* v. *Atrium Inv. Partnership*, 740 F.2d 148 (2d Cir. 1984) (affirming the dismissal of an Exchange Act claim because the parties had agreed to try all disputes in the Netherlands).

12 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9541 (Rule 601); N.A.S.D. Manual (CCH) ¶ 3719; 2 N.Y.S.E. Guide (CCH) ¶ 2607 (Rule 607); Uniform Code of Arbitration § 8.

13 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542 (Rule 602); N.A.S.D. Manual (CCH) ¶ 3719; 2 N.Y.S.E. Guide (CCH) ¶ 2607 (Rule 607); Uniform Code of Arbitration § 8. As noted above at 9-10, the 1988 SICA proposed rule changes would set specific criteria for qualification as a "public" arbitrator. *See* Proposed N.Y.S.E. Rules 607, 608, 610 at A-4-7; N.Y.S.E. Guidelines for Classification of Arbitrators at A-20-21.

appearance of a conflict of interest.[14] Each party in an arbitration is accorded at least one peremptory challenge.[15]

The arbitration itself proceeds much like a trial. The parties have the right to be present at the hearing, to be represented by counsel, to cross-examine witnesses, and to take a transcript of the hearing. They may subpoena witnesses and documents just as in a court proceeding, and may also compel the presence of any employee of a member of the sponsoring institution at a hearing, regardless of whether that employee would be within the subpoena power of the courts of the state where the hearing is held.[16] Moreover, arbitrators serve, and witnesses testify, under oath.[17] The fairness of these rules and procedures is borne out by the results of arbitrations conducted under them. In 1987, 55% of public customer cases that went to arbitration before one of the securities exchanges or the N.A.S.D. and were decided—rather than settled—awarded damages to the customer.[18] A study prepared for the NYSE by the accounting firm of Deloitte Haskins & Sells ("DH&S") of arbitration and litigation results of customer public cases of six major brokerage firms suggests that arbitration may offer at least as favorable

14 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542(f) (Rule 602)(f); N.A.S.D. Manual (CCH) ¶ 3723; 2 N.Y.S.E. Guide (CCH) ¶ 2610 (Rule 610); Uniform Code of Arbitration § 11.

15 *See, e.g.*, Uniform Code of Arbitration § 10.

16 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶¶ 9546, 9548-49, 9551A (Rules 606, 608-09, 612); 2 N.Y.S.E. Guide (CCH) ¶¶ 2614-15, 2619-20, 2624 (Rules 614-15, 619-624); Uniform Code of Arbitration §§ 15-16, 20-21, 25.

17 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9551B (Rule 613); 2 N.Y.S.E. Guide (CCH) ¶ 2625 (Rule 625); Uniform Code of Arbitration § 26.

18 *See* Minutes of the June 24, 1988, Meeting of the Securities Industry Conference on Arbitration, which reported arbitration statistics for 1987 similar to those previously reported to the Securities and Exchange Commission. A table of these statistics, and of the 1986 statistics compiled by SICA, is set forth as Appendix A to the Brief of the Securities Industry Association as *amicus curiae* in support of the petition for a writ of *certiorari* herein.

results as litigation to public customers.[19] According to the DH&S survey, which reflects data from a three month period during 1987 and 1988, litigation plaintiffs recovered 2.6% of their original claims (including settlements), as opposed to 14.81% (including settlements) for arbitration claimants.[20]

Moreover, the arbitration process significantly reduces discovery expenses and minimizes delay in reaching a hearing. *See Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. at 628; C. Katsoris, *The Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279, 286 (1984). For example, state laws generally provide subpoena power to arbitrators and counsel, and parties are encouraged to produce documents "to the fullest extent possible without resort to the issuance of the subpoena process."[21] Arbitrators may also direct the appearance of persons associated with member organizations or the production of records of these organizations without using the subpoena process.[22] That most stock exchanges and the N.A.S.D offer a streamlined arbitration procedure for smaller claims also enables customers to resolve small disputes without

19 The DH&S survey, which was annexed by the NYSE to its response to the Commission, and which was also filed with the United States District Court for the District of Massachusetts in *Securities Industry Association* v. *Connally*, Civil Action No. 88-2153-WD as an Exhibit to the Affidavit of Paul J. Dubow, sworn to November 28, 1988, and cited by the Court in its opinion granting summary judgment in favor of SIA, [Current] Fed. Sec. L. Rep. (CCH) ¶ 94,107 at 91,217 (D. Mass. Dec. 18, 1988), is set forth as Appendix B to this brief.

20 *See* Appendix B at A-24.

21 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9548 (Rule 608); N.A.S.D. Manual (CCH) ¶ 3732; 2 N.Y.S.E. Guide (CCH) ¶ 2619 (Rule 619); Uniform Code of Arbitration § 20; C. Katsoris, *supra*, at 286. As noted above at 10, the proposed amendment to the SICA code would provide specific deadlines for responses to discovery requests, *see* Appendix A, Proposed N.Y.S.E. Rule 619(a)(b)(2), at A-12, and for discovery conferences, *see* Appendix A, Proposed N.Y.S.E. Rule 619(d), at A-13.

22 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9549 (Rule 609); N.A.S.D. Manual (CCH) ¶ 3733; 2 N.Y.S.E. Guide (CCH) ¶ 2620 (Rule 620); Uniform Code of Arbitration § 21.

incurring great expense.[23] Arbitration also offers an expeditious result. According to statistics compiled by SICA, 4,364 securities industry arbitrations were filed with securities exchanges and the N.A.S.D. in 1987, and 2,936 arbitrations in the securities industry were resolved during that year.[24] The 1987 figures represent more than three times the number of arbitrations filed in 1982.[25]

Finally, the excessive caseload in the federal district courts makes it all the more important that arbitrable claims between securities firms and their customers proceed to arbitration. Filings of securities and commodities claims increased to 2,844 in 1987.[26] Since the average caseload per United States District Judge in 1987 was 460 cases,[27] permitting agreements to arbitrate all securities laws claims would help to relieve the federal courts of their overloaded dockets and could effectively free as many as six federal district judges to handle other matters.

Wilko thus stands bereft of any factual, legal, or policy support. *Amici* respectfully submit that *Wilko*'s negation of congressional policy, its analytical inconsistency with this Court's

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23 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9551H (Rule 619); N.A.S.D. Manual (CCH) ¶ 3710; 2 N.Y.S.E. Guide (CCH) ¶ 2601 (Rule 601); Uniform Code of Arbitration § 2.

24 *See* Brief of the Securities Industry Association as *amicus curiae* in support of the petition for a writ of *certiorari* herein, Appendix A.

25 The number of filings rose from 1,340 in 1982 to 4,364 in 1987. *See* Fifth Report of the Securities Industry Conference on Arbitration Statistical Report (April 1986) (Exhibit A), which is reproduced in Appendix B to the Brief of the Securities Industry Association as *amicus curiae* in support of the petition for a writ of *certiorari* herein.

26 Annual Report of the Director of the Administrative Office of the United States Courts, Appendix I, Table C2 (1987). This table is reproduced in excerpted form as Appendix C to the Brief of the Securities Industry Association as *amicus curiae* in support of the petition for a writ of *certiorari* herein. These figures are calculated on the basis of a year beginning July 1; "1987" statistics therefore refer to the period July 1, 1986, through June 30, 1987.

27 Administrative Office of the United States Courts, Federal Court Management Statistics 1987 at 167.

more recent decisions, and its invalid factual assumptions take it out of the shelter of *stare decisis*. As the Court has long recognized, "*stare decisis*, in statutory construction, is a useful rule, not an inexorable command." *Erie Railroad Co.* v. *Tompkins*, 304 U.S. 64, 92 (1938) (Reed, J., concurring). Thus, the Court has overturned its own precedent in order to achieve consistency in interpreting statutory provisions. *See Commissioner* v. *Estate of Church*, 335 U.S. 632 (1949). The Court in *Church* reconsidered the construction of the "possession or enjoyment" clause under Section 811(c) of the Internal Revenue Code it had adopted in *May* v. *Heiner*, 281 U.S. 238 (1930). It did so because its subsequent decision in *Helvering* v. *Hallock*, 309 U.S. 106 (1940), had construed the same "possession or enjoyment" clause in Section 811(c) of the Code differently from *May*. *Church* found that the decision in *Hallock* amounted to a complete rejection of the rationale in *May*, even though it did not expressly overrule *May*. *Commissioner* v. *Estate of Church*, 335 U.S. at 643-45. While acknowledging the interests inherent in the doctrine of *stare decisis*, the Court overruled *May* in order to bring an inconsistent holding in line with its later decision. *See Commissioner* v. *Estate of Church*, 335 U.S. at 649-50. As stated in *Helvering* v. *Hallock*, where the Court was also confronted with incompatible decisions, the "real problem . . . is to determine whether we are to adhere to a harmonizing principle . . . or whether we are to multiply gossamer distinctions between the present cases and the . . . earlier ones." 309 U.S. at 118. Here, too, a holding that Section 12(2) claims are arbitrable would make the law with respect to those claims consistent with the law regarding Exchange Act claims.

Likewise, the Court has not hesitated to overrule decisions that "do not state the correct rule of law." *See Girouard* v. *United States*, 328 U.S. 61, 69 (1946) (overruling *United States* v. *Schwimmer*, 279 U.S. 644 (1929), *United States* v. *MacIntosh*, 283 U.S. 605 (1931), and *United States* v. *Bland*, 283 U.S. 636 (1931)). Here, again, where *Wilko*'s legal reasoning and policy consideration cannot pass muster under this Court's

more recent Arbitration Act decisions, *Wilko* cannot "state the correct rule of law" and should therefore be overruled.

Last, should the Court overrule *Wilko*, it will bestow the additional policy advantage of making the law uniform for all securities law claims. Parties will have no incentive to continue to plead a Section 12(2) claim as a means of avoiding arbitration.[28] The federal court system will therefore be spared substantial motion practice over pleading matters, as a well as over difficult collateral estoppel issues that invariably arise when claims arising under the same set of facts must be resolved by different tribunals.

POINT II

WILKO V. *SWAN* IGNORED THE STANDARD FOR FINDING AN IMPLIED REPEAL OF THE UNITED STATES ARBITRATION ACT

By holding that Section 12(2) claims are not arbitrable on the basis of its own perception of arbitration practice, *Wilko* usurped Congress's role in setting federal policy. Specifically, while purporting to resolve a conflict between "two policies, not easily reconcilable", 346 U.S. at 438, *Wilko* in fact manufactured that conflict on the basis of its hostility to arbitration. Notwithstanding Congress's policy favoring arbitration, *Wilko* equated an agreement to arbitrate Securities Act claims with a waiver of compliance with the Securities Act in order to void such an agreement under Section 14.

Wilko's analysis stands at odds with many of this Court's more recent rulings, in particular *McMahon* and *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc. Mitsubishi*

28 *Dain Bosworth Incorporated* v. *Johnson* appears to be a good example of this sort of practice. In *Johnson*, the plaintiffs originally brought a claim under the Minnesota Securities Act. When the defendants moved to compel arbitration, the plaintiffs amended their complaint to add a Section 12(2) claim and then again to delete their Minnesota Securities Act claim so that it could not be arbitrated. *See Dain Bosworth Incorporated* v. *Johnson*, No. 88-284, Petition for a Writ of *Certiorari* at 4-5, A-15-47.

requires that any finding of an implied repeal of the Arbitration Act be supported by "congressional intention expressed in some other statute . . . ." 473 U.S. at 627. This is simply a reiteration of the traditional standard for finding that a federal statute has been repealed by implication by a subsequently enacted federal statute. *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. at 88 (" 'repeals by implication [of a prior statue by a subsequently enacted one] are disfavored' ") (quoting *Allen* v. *McCurry*, 449 U.S. 90, 99 (1980)); *Morton* v. *Mancari*, 417 U.S. at 550 ("In the absence of some affirmative showing of an intention [by Congress] to repeal, the only permissible justification for a repeal by implication is when the earlier and later statutes are irreconcilable").

In *Mitsubishi*, this Court stated:

> We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history.

473 U.S. at 628[29]

Under this test, there can be no question that predispute agreements to arbitrate Section 12(2) claims are enforceable under the Arbitration Act. The Securities Act contains no statutory language that restricts a party's ability to choose an arbitral forum with respect to claims brought thereunder. Section 14, on which *Wilko* relied, concerns waivers of compliance with the Securities Act, not agreements as to what forum a claim under the Securities Act may be tried before. This Court has already marked this distinction in *Mitsubishi* and *McMahon* to the extent of holding that Section 29 of the Exchange Act, a nonwaiver provision substantially identical to Section 14, did not void agreements to arbitrate in *McMahon*.

29 The opinion in *Mitsubishi* cited *Wilko* v. *Swan* for this proposition, in spite of the fact that *Wilko* did not rely on text or legislative history, but rather on its hostile view of arbitration practice and its conception of an agreement to arbitrate statutory claims as a waiver of compliance with the statute in question, both of which notions *Mitsubishi* rejected in no uncertain terms.

Nor is there any evidence in the legislative history of the Securities Act that Congress intended to repeal the Arbitration Act with respect to Securities Act claims. That Congress in amending the securities laws in 1975 did not affirmatively overrule *Wilko* has no bearing on what Congress intended in 1933, the critical inquiry at bar. Likewise, although the Conference Report pertaining to those amendments observed that the amendments were not intended to change existing law as to waivers and then cited *Wilko* v. *Swan*, that language is not connected with any affirmative act of Congress, either in 1975 or in 1933, and hardly amounts to the direct legislation necessary to repeal the Arbitration Act in this context. *See* H.R. Conf. Rep. No. 94-229, at 111 (1975), *reprinted in* 1975 U.S. Code Cong. & Ad. News, at 179, 342. Indeed, the Court in *McMahon* found the language quoted from that Conference Report so obscure as not to be probative of anything, with the result that "the *Wilko* issue was left to the courts." 107 S. Ct. at 2343. Moreover, such subsequent legislative inaction will not prevent a Court from revisiting a decision that was ill-founded, as *amici* respectfully suggest is the case here. For example, in *Girouard* v. *United States*, the Court overruled its prior interpretation of a statute after Congress had rejected amendments to that statute that would have overruled the prior interpretation. *See* 328 U.S. at 72-76 (Stone, C.J., dissenting). As the majority held, "it is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law. We do not think under the circumstances of this legislative history that we can properly place on the shoulders of Congress the burden of the Court's own error." 328 U.S. at 69-70.

Absent specific legislative evidence to the contrary, the Arbitration Act must apply to Securities Act claims and agreements to arbitrate those claims must be honored as ordinary contracts.

CONCLUSION

For the reasons set forth above, *amici curiae* the Securities Industry Association, D.A. Davidson & Co., Inc., Dain Bosworth Incorporated, Dean Witter Reynolds Inc., Goldman, Sachs & Co., J.C. Bradford & Co., J.J.B. Hilliard, W.L. Lyons, Inc., Johnston Lemon & Co. Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Piper, Jaffray & Hopwood Inc., The Advest Group, Inc., and Wheat, First Securities, Inc., respectfully request that the decision of the United States Court of Appeals for the Fifth Circuit below be affirmed.

Dated: February 17, 1989

Respectfully submitted,

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APPENDIX A

PROPOSED AMENDMENTS TO THE ARBITRATION RULES OF THE NEW YORK STOCK EXCHANGE, INC., AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON OCTOBER 17, 1988, FILE NO. SR-NYSE-88-29

[ ] DELETED LANGUAGE
italics NEW LANGUAGE

Rule 601. SIMPLIFIED ARBITRATION

(a) Any dispute, claim or controversy, arising between a public customer(s) and an associated person or a member subject to arbitration under this Code involving a dollar amount not exceeding $10,000 exclusive of attendant costs and interest, shall upon demand of the customer(s) or, by written consent of the parties, be arbitrated as hereinafter provided.

(b) The Claimant shall file with the Director of Arbitration [one (1) executed Submission Agreement and one (1) copy of the Statement of Claim of the controversy in dispute,] *an executed Submission Agreement and a copy of the Statement of Claim of the controversy in dispute and the required deposit*, together with documents in support of the Claim. *Sufficient copies of the Submission Agreement and the Statement of Claim and supporting documents shall be provided to the Director of Arbitration for each party and the arbitrator.* The Statement of Claim shall specify the relevant facts, the remedies sought and whether or not a hearing is demanded.

(c) The claimant shall pay the sum of $15.00 if the amount in controversy is $1,000 or less, $25.00 if the amount in controversy is more than $1,000 but $2,500 or less, $100 if the amount in controversy is more than $2,500 but does not exceed $5,000, or $200 if the amount in controversy is more than $5,000 but does not exceed $10,000 upon filing

of the Submission Agreement. The final disposition of this sum shall be determined by the arbitrator.

(d) The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the Respondent(s) one (1) copy of the Submission Agreement and one (1) copy of the Statement of Claim.

[The respondent(s) shall, within twenty (20) calendar days from receipt of service, file with the Director of Arbitration one (1) executed Submission Agreement and one (1) copy of the Respondent's Answer, together with supporting documents.]

Within twenty (20) calendar days from receipt of the Statement of Claim, Respondent(s) shall serve each party with an executed Submission Agreement and a copy of Respondent's Answer. Respondent's executed Submission Agreement and Answer shall also be filed with the Director of Arbitration with sufficient copies for the arbitrator(s) along with any deposit required under the schedule of fees. The Answer shall designate all available defenses to the Claim and may set forth any related Counterclaim and/or related Third Party Claim the Respondent(s) may have against the Claimant or any other person. If the Respondent(s) has interposed a Third Party Claim, [The Director of Arbitration shall endeavor to serve promptly by mail or otherwise a copy of same, together with a copy of the Submission Agreement on such Third Party who shall respond in the manner herein provided for response to the claim.] *the Respondent(s) shall serve the Third Party Respondent with an executed Submission Agreement, a copy of Respondent's Answer containing the Third Party Claim and a copy of the original Claim filed by the Claimant. The Third Party Respondent shall respond in the manner herein provided for response to the claim.* If the Respondent(s) files a related Counterclaim exceeding $10,000, the arbitrator may refer the Claim, Counterclaim and/or Third Party Claim if any, to a panel of three (3) or more arbitrators in

accordance with Rule 607 *of this Code* or, he may dismiss the Counterclaim and/or Third Party Claim, without prejudice to the Counterclaimant(s) and/or Third Party Claimant(s) pursuing the Counterclaim and/or Third Party Claim in a separate proceeding. *The costs to the Claimant under either proceeding shall in no event exceed $200.*

(e) [The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the Claimant a copy of the Answer, Counterclaim, Third Party Claim or other responsive pleading, if any. The Claimant, if a Counterclaim is asserted against him, shall within ten (10) calendar days either (i) file a Reply to any Counterclaim with the Director of Arbitration who will serve a copy of the Reply on the Respondent(s) or,] *All parties shall serve promptly by mail or otherwise on all other parties and the Director of Arbitration, with sufficient copies for the arbitrators, a copy of the Answer, Counterclaim, Third Party Claim or other responsive pleading, if any. The Claimant, if a Counterclaim is asserted against him, shall within ten (10) calendar days either:*

(i) serve on each party a reply to any counterclaim, or

(ii) if the amount of the Counterclaim exceeds the Claim, have the right to file a statement withdrawing the Claim. If the Claimant withdraws the Claim, the proceedings will be discontinued without prejudice to the rights of the parties.

(f) The dispute, claim or controversy shall be submitted to a single arbitrator knowledgeable in the securities industry selected by the Director of Arbitration. Unless the public customer demands or consents to a hearing, or the arbitrator(s) calls a hearing, the arbitrator shall decide the dispute, claim or controversy solely upon the pleadings and evidence filed by the parties. If a hearing is necessary, such hearing shall be held as soon as practicable at a locale selected by the Director of Arbitration.

(g) The Director of Arbitration may grant extensions of time to file any pleading upon a showing of good cause.

(h) The arbitrator shall be authorized to require the submission of further documentary evidence as he, in his sole discretion deems advisable.

(i) Upon the request of the arbitrator, the Director of Arbitration shall appoint two (2) additional arbitrators to the panel which shall decide the matter in controversy.

(j) In any case where there is more than one (1) arbitrator, the majority will be public arbitrators.

(k) In his discretion, the arbitrator may, at the request of any party, permit such party to submit additional documentation relating to the pleadings.

(l) Except as otherwise provided herein, the general arbitration rules of the New York Stock Exchange, Inc. shall be applicable to proceedings instituted under this Code.

Rule 607. DESIGNATION OF NUMBER OF ARBITRATORS

(a) (1) In all arbitration matters involving public customers and non-members where the matter in controversy exceeds $10,000, or where the matter in controversy does not involve or disclose a money claim, the Director of Arbitration shall appoint an arbitration panel which shall consist of no less than three (3) arbitrators, at least a majority of whom shall not be from the securities industry, unless the public customer or non-member requests a panel consisting of at least a majority from the securities industry.

(2) *An arbitrator will be deemed as being from the securities industry if he or she is:*

1. is a person associated with a member, or broker/dealer, government securities broker, government securities dealer or registered investment adviser, or

2. has been associated with any of the above within the past three (3) years, or

3. is retired from any of the above, or

4. is an attorney, accountant or other professional who devoted twenty (20) percent or more of his or her professional work effort to securities industry clients within the last two (2) years.

(3) *An arbitrator who is not from the securities industry shall be deemed a public arbitrator. A person will not be classified as a public arbitrator if he or she has a spouse or other member of the household who is a person associated with a registered broker, dealer, municipal securities dealer, government securities broker, government securities dealer or investment adviser.*

(b) Composition of Panels

The individuals who shall serve on a particular arbitration panel shall be determined by the Director of Arbitration. The Director of Arbitration may name the chairman of each panel.

Rule 608. NOTICE OF SELECTION OF ARBITRATORS

The Director of Arbitration shall inform the parties of the names [and business affiliations of the arbitrators] *and employment histories of the arbitrators for the past ten years, as well as information disclosed pursuant to Rule 610* at least eight (8) business days prior to the date fixed for the initial hearing session. *A party may make further inquiry of the Director of Arbitration concerning an arbitrator's background. In the event that any arbitrator, after appointment and prior to the first hearing session, should resign, die, withdraw, be disqualified or otherwise be unable to perform as an arbitrator, the Director of Arbitration shall appoint a new member to the panel to fill any vacancy. The Director of Arbitration shall inform the parties of the name and employment history of the arbitrator for the past*

ten years, as well as information disclosed pursuant to Rule 610, as soon as possible. A party may make further inquiry of the Director of Arbitration concerning the background of any arbitrator and within the time remaining prior to the first hearing session or the five (5) day period provided under Rule 609, whichever is shorter, may exercise its right to challenge the replacement arbitrator as provided in Rule 609.

Rule 610. DISCLOSURES REQUIRED OF ARBITRATORS

(a) Each arbitrator shall be required to disclose to the Director of Arbitration any circumstances which might preclude such arbitrator from rendering an objective and impartial determination.

[Prior to the commencement of the first hearing session the Director of Arbitration may remove an arbitrator who discloses such information.]

Each arbitrator shall disclose:

(1) Any direct or indirect financial or personal interest in the outcome of the arbitration;

(2) Any existing or past financial, business, professional, family or social relationships which are likely to affect impartiality or which might reasonably create an appearance of partiality or bias. Persons requested to serve as arbitrators should disclose any such relationships which they personally have with any party or its counsel, or with any individual whom they have been told will be a witness. They should also disclose any such relationship involving members of their families or their current employers, partners or business associates.

(b) Persons who are requested to accept appointment as arbitrators should make a reasonable effort to inform themselves of any interests or relationships described in Paragraph (a) above.

(c) The obligation to disclose interests, relationships, or circumstances which might preclude an arbitrator from rendering an objective and impartial determination described in subsection (a) hereof is a continuing duty which requires a person who accepts appointment as an arbitrator to disclose, at any stage of the arbitration, any such interests, relationships, or circumstances which arise, or which are recalled or discovered.

(d) Prior to the commencement of the first hearing session, the Director of Arbitration may remove an arbitrator based on information disclosed pursuant to this section. The Director of Arbitration shall also inform the parties of any information disclosed pursuant to this section, if the arbitrator who disclosed the information is not removed.

Rule 611. DISQUALIFICATION OR OTHER DISABILITY OF ARBITRATORS

[In the event that any arbitrator, after the commencement of the first session but prior to the rendition of the award should become disqualified, resign, die, refuse or be unable to perform or discharge his duties, the Director of Arbitration, upon such proof as he deems satisfactory, shall, where permited by law, either (a) appoint a new member to the panel to replace such arbitrator, obtaining the consent of the parties; or (b) with the consent or waiver of the parties, direct that the arbitration proceed without the substitution of a new arbitrator.]

In the Event that any arbitrator, after the commencement of the first hearing sessions and prior to the rendition of the award, should resign, die, withdraw, be disqualified or otherwise be unable to perfo.m as an arbitrator, the remaining arbitrator(s) may continue with the hearing and determination of the controversy, unless such continuation is objected to by any party within five (5) days of notification of such resignation, death, withdrawal, disqualification, or other inability. Upon objection, the Director of Arbitration shall appoint a new member to the panel to fill any vacancy. The Director of Arbitration

shall inform the parties as soon as possible of the name and employment history for the past ten (10) years of the replacement arbitrator, as well as information disclosed pursuant to Rule 610. A party may make further inquiry of the Director of Arbitration concerning the replacement arbitrator's background and within the time remaining prior to the next scheduled hearing session or the five (5) day period provided under Rule 609, whichever is shorter, may exercise its right to challenge the replacement arbitrator as provided in Rule 609.

Rule 612. INITIATION OF PROCEEDINGS

Except as otherwise provided herein, an arbitration proceeding under this Code shall be instituted as follows:

(a) Statement of Claim

The Claimant shall file with the Director of Arbitration [three (3) executed copies of the Submission Agreement and three (3) copies of the Statement of Claim of the controversy in dispute, together with the documents in support of the claim.] *an executed Submission Agreement, a Statement of Claim and the required deposit. Sufficient copies of the Submission Agreement and the Statement of Claim and supporting documents shall be provided to the Director of Arbitration for each party and arbitrator(s).* The Statement of Claim shall specify the relevant facts and the remedies sought. The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the Respondent(s) one (1) copy of the Submission Agreement and one (1) copy of the Statement of Claim.

(b) Service and Filing with the Director of Arbitration

For purposes of the Code of Arbitration Procedure, service may be effected by mail or other means of delivery. Service and filing are accomplished on the date of mailing with first-class postage pre-paid or, in the case of other means of service, on the date of delivery. Filing with the Director of Arbitration shall be made on the same date as service.

[(b)]*(c) Answers—Defenses, Counterclaims and/or Cross-Claims*

[(1) The Respondent(s) shall within twenty (20) business days from receipt of service file with the Director of Arbitration one (1) copy of the Respondent's(s') Answer.]

(1) Within twenty (20) business days from receipt of the Statement of Claim, the Respondent(s) shall serve each party with an executed Submission Agreement and a copy of Respondent(s) Answer. Respondent(s) executed Submission Agreement and Answer shall also be filed with the Director of Arbitration with sufficient copies for the arbitrator(s), along with any deposit required under the schedule of fees. The Answer shall specify all available defenses and relevant facts that will be relied upon at the hearing and may set forth any related Counterclaim the Respondent(s) may have against the Claimant, [and any third party claim against any other party or person upon any existing dispute, claim or controversy to arbitration under this Code.] *any Cross-Claim, the Respondent(s) may have against any other named Respondent(s) and any Third Party Claim against any other party or person upon any existing dispute, claim or controversy subject to arbitration under this Code.*

(2) (i) A Respondent, Responding Claimant, Cross-Claimant, *Cross-Respondent* or Third Party Respondent who pleads only a general denial as an answer may, [upon written objection by the adversary party before the hearing to the Director of Arbitration] *upon objection by a party*, in the discretion of the arbitrators, be barred from presenting any fact or defenses at the time of the hearing.

(ii) A Respondent, Responding Claimant, Cross-Claimant, *Cross-Respondent* or Third Party

Respondent who fails to specify all available defenses and relevant facts in such party's answer may, upon objection by [the adversary] *a* party, in the discretion of the arbitrators, be barred from presenting such facts or defenses *not included in such party's answer* at the hearing.

(iii) A Respondent, Responding Claimant, Cross-Claimant, *Cross-Respondent* or Third Party Respondent who fails to file an answer within twenty (20) business days from receipt of service, or unless the time to answer has been extended pursuant to paragraph (5), may, in the discretion of the arbitrators, be barred from presenting any matter, arguments or defenses at the hearing.

(3) [If the Respondent(s) has interposed a third party claim the Director of Arbitration shall endeavor to serve promptly by mail or otherwise a copy of same together with a copy of the Submission Agreement on such third party who shall respond in the manner herein provided for response to the Claim.] *Respondent(s) shall serve each party with a copy of any Third Party Claim. The Third Party Claim shall also be filed with the Director of Arbitration with sufficient copies for the arbitrator(s), along with any deposit required under the schedule of fees. Third Party Respondent(s) shall respond in the manner provided for response to the Claim, as provided herein above.*

(4) [The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the Claimant a copy of the Answer, Counterclaim, Third Party Claim or other responsive pleading, if any. The Claimant may within ten (10) business days file a Reply to the Counterclaim with the Director of Arbitration who will serve a copy of the Reply on the Respondent(s).] *The Claimant shall serve each party*

with a reply to a counterclaim within ten (10) business days of receipt of an answer containing a counterclaim. The reply shall also be filed with the Director of Arbitration with sufficient copies for the arbitrator(s).

(5) [The time period to file any pleading, whether such be denominated as a Claim, Answer, Counterclaim, Reply or Third Party pleading, may be extended for such further periods as may be granted by the Director of Arbitration.] *The Director of Arbitration may extend any time period in this section whether such be denominated as a Claim, Answer, Counterclaim, Cross-Claim, Reply or Third Party pleading.*

[(c)]*(d)* Joining and Consolidation—Multiple Parties.

(1) With respect to any dispute, claim or controversy submitted to arbitration, any party or person eligible to submit a claim under this Code shall have the right to proceed in the same arbitration against any other party or person upon any claim directly related to such dispute.

(2) For purposes of this subsection, the Director of Arbitration shall be authorized to determine preliminarily whether a claim is directly related to the matter in dispute and to join any other party to the dispute and to consolidate the matter for hearing and award purposes. In arbitrations where there are multiple Claimants, Respondents and/or Third Party Respondents, the Director of Arbitration shall be authorized to determine preliminarily whether such parties should proceed in the same or separate arbitrations.

(3) All final determinations with respect to joining, consolidation and multiple parties under this subsection shall be made by the arbitration panel.

Rule 619. GENERAL PROVISION GOVERNING PRE-HEARING PROCEEDING

(a) Requests for Documents and Information

The parties shall cooperate to the fullest extent practicable in the voluntary exchange of information to expedite the arbitration. Any request for documents or other information should be specific, relate to the matter in controversy, and afford the party to whom the request is made a reasonable period of time to respond without interfering with the time set for the hearing.

(b) Document Production and Information Exchange

(1) Any party may serve a written request for information or documents ("information request") upon another party twenty (20) business days or more after service of the Statement of Claim by the Director of Arbitration or upon filing of the Answer, whichever is earlier. The requesting party shall serve the information request on all parties and file a copy with the Director of Arbitration. The parties shall endeavor to resolve disputes regarding an information request. Such efforts shall be set forth in the objection.

(2) Unless a greater time is allowed by the requesting party, information requests shall be satisfied or objected to within thirty (30) calendar days from the date of service. Any objection to an information request shall be served by the objecting party on all parties and filed with the Director of Arbitration.

(3) Any response to objections to information requests shall be served on all parties and filed with the Director of Arbitration within ten (10) calendar days of receipt of the objection.

(4) Upon the written request of a party whose information request is unsatisfied, the matter will be referred by the Director of Arbitration to either a pre-hearing conference under paragraph (d) of this section or to a

selected arbitrator under paragraph (e) of this section.

(c) Pre-Hearing Exchange

At least ten (10) calendar days prior to the first scheduled hearing date, all parties shall serve on each other copies of documents in their possession and shall identify witnesses they intend to present at the hearing. The arbitrator(s) may exclude from the arbitration, any documents not exchanged or witnesses not identified. This paragraph does not require service of copies of documents or identification of witnesses which parties may use for cross-examination or rebuttal.

(d) Pre-Hearing Conference

(1) Upon the written request of a party, an arbitrator, or at the discretion of the Director of Arbitration, a pre-hearing conference shall be scheduled. The Director of Arbitration shall set the time and place of a pre-hearing conference and appoint a person to preside. The pre-hearing conference may be held by telephone. The presiding person shall seek to achieve agreement among the parties on any issues that relate to the pre-hearing process or to the hearing, including but not limited to, the exchange of information, exchange or production of documents, identification of witnesses, identification and exchange of hearing documents, stipulations of facts, identification and briefing of contested issues, and any other matters which will expedite the arbitration proceedings.

(2) Any issues raised at the pre-hearing conference that are not resolved may be referred by the Director of Arbitration to a single member of the Arbitration Panel for decision.

(e) Decisions by Selected Arbitrator

The Director of Arbitration may appoint a single member of the Arbitration Panel to decide all unresolved

issues referred to under this section and sections (f) and (g). Such arbitrator shall be authorized to act on behalf of the panel to issue subpoenas, direct appearances and production of documents, and set deadlines. Decisions under this paragraph shall be made upon the papers submitted by the parties, unless the arbitrator calls a hearing. The arbitrator may elect to refer any issue under this paragraph to the full panel.

(f) Subpoenas

The arbitrator(s) and any counsel of record to the proceedings shall have the power of the subpoena process as provided by law. *All parties shall be given a copy of the subpoena upon its issuance.* [However] The parties shall produce witnesses and present proofs to the fullest extent possible without resort to the [issuance of the] subpoena process.

[(b) Prior to the first hearing session, the parties shall cooperate in the voluntary exchange of such documents and information as will serve to expedite the arbitration. If the parties agree, they may also submit additional documents to the Director of Arbitration for forwarding to the arbitrators.]

(g) Power to Director Appearance and Production of Documents

The arbitrator(s) shall be empowered without resort to the subpoena process to direct the appearance of any person employed or associated with any member or member organization of the New York Stock Exchange, Inc. and/or the production of any records in the possession or control of such persons or members. Unless the arbitrator(s) direct otherwise, the party requesting the appearance of a person or the production of documents under this section shall bear all reasonable costs of such appearance and/or production

Rule 623. RECORD OF PROCEEDINGS

[Unless requested by the arbitrators or a party or parties to a dispute, no record of any arbitration proceeding is required to be kept. If a record is kept, it shall be a verbatim record.] *A verbatim record by stenographic reporter or tape recording of all arbitration hearings shall be kept.* If a party or parties to a dispute elect to have the record transcribed, the cost of such transcription shall be borne by the party or parties making the request *unless the arbitrators direct otherwise. The arbitrators may also direct that the record be transcribed. If the record is transcribed at the request of any party, a copy shall be provided to the arbitrators.*

Rule 627. AWARDS

(a) All awards shall be in writing and signed by a majority of the arbitrators or in such manner as it is required by law. Such awards may be entered as a judgment in any court of competent jurisdiction.

(b) Unless the law directs otherwise, all awards rendered pursuant to this Code shall be deemed final and not subject to review or appeal.

(c) The Director of Arbitration shall endeavor to serve a copy of the award: (i) by registered or certified mail upon all parties or their counsel, at the address of record; or (ii) by personally serving the award upon the parties; or (iii) by filing or delivering the award in such a manner as may be authorized by law.

(d) The arbitrator(s) shall endeavor to render an award within thirty (30) business days from the date the record is closed.

(e) The award shall contain the names of the parties, a summary of the issues in controversy, the damages and/or other relief requested, the damages and/or other relief awarded, a statement of any other issues resolved, the

names of the arbitrators and the signatures of the arbitrators concurring in the award.

(f) Summary information contained in the awards shall be made publicly available in accordance with the policies of the sponsoring self-regulatory organization.

Rule 629. SCHEDULE OF FEES *FOR CUSTOMER DISPUTES*

(a) At the time of filing a [Submission Agreement, a Claimant] *Claim, Counterclaim, Third-Party Claim or Cross-Claim, a party* shall deposit with the Exchange the amount indicated below unless such deposit is specifically waived by the Director or Arbitration

Amount in Dispute (Exclusive of interest and expenses)	Deposit
$1,000 or less	$ 15
Above $1,000 but not exceeding $2,500	$ 25
Above $2,500 but not exceeding $5,000	$ 100
Above $5,000 but not exceeding $10,000	$ 200
Above $10,000 but not exceeding $50,000	$ 400
Above $50,000 but not exceeding $100,000	$ 500
Above $100,000 but not exceeding $500,000	$ 750
Above $500,000	$1,000

Where the amount in dispute is $10,000 or less, no additional deposits shall be required despite the number of *hearing* sessions. Where the amount in dispute is above $10,000 and multiple *hearing* sessions are required, the arbitrators may require any of the parties to make additional deposits for each additional *hearing* session. In no event shall the aggregate amount deposited per *hearing* session exceed the amount of the initial deposit(s) as set forth in the above schedule.

(b) *A hearing session is any meeting between the parties and the arbitrator(s), including a pre-hearing conference, which lasts four (4) hours or less.*

[(b)]*(c)* The arbitrators, in their awards, may determine the amount chargeable to the parties as forum fees (fees) and shall determine by whom such fees shall be borne. Where the amount in dispute is $10,000 or less, total [forum] fees chargeable to the parties shall not exceed the amount *of the total initial deposit* deposited *by the parties, regardless of the number of hearing sessions conducted. Where the amount in dispute is above $10,000, total fees chargeable to the parties per hearing session may equal but shall not exceed the amount of the total initial deposit(s) deposited by the parties.* [Where the amount in dispute is above $10,000 but does not exceed $50,000, the maximum fee shall be $400 per session. Where the amount in dispute is above $50,000 but does not exceed $100,000, the maximum fee shall be $500 per session. Where the amount in dispute is above $100,000, the maximum fee shall be $750 per session. Where the amount in dispute is above $500,000, the maximum fee shall be $1,000 per session.] Amounts deposited by a party shall be applied against fees, if any. If the fees are not assessed against a party who had made a deposit, the deposit will be refunded. *In addition to forum fees, the arbitrator(s) may determine in their awards the amount of costs incurred pursuant to Rules 617, 619 and 624; and unless applicable law directs otherwise, other costs and expenses of the parties and arbitrator(s) which are within the scope of the agreement of the parties. The arbitrator(s) shall determine by whom such costs shall be borne.*

[(c)]*(d)* If the dispute, Claim or controversy does not involve or disclose a money Claim, the amount to be deposited by the Claimant shall be [$100] *$200*, or such amount as the Director of Arbitration or the panel of arbitrators may require, but shall not exceed $1,000.

[(d)]*(e)* Any matter submitted and thereafter settled or withdrawn prior to the commencement of the first *hearing* session shall entitle the parties to a refund of all but $100 of the amount deposited with the Association. This sec-

tion shall not apply to claims filed under Section 2 of this Code.

[(e)]*(f)* Any matter submitted and thereafter settled or withdrawn subsequent to the commencement of the first *hearing* sessions may be subject to such refund of assessed deposits, if any, as the panel of arbitrators presiding may determine.

[(f)]*(g)* The arbitrators may assess forum fees and *costs incurred pursuant to* Rules 617, 619 and 624 [Rule 620 costs] in any matter settled or withdrawn subsequent to the commencement of the first session.

(h) The fee for pre-hearing conferences shall be 75 per cent of the fees contained in subsection (a).

[Rule 620. POWER TO DIRECT APPEARANCES

The arbitrators shall be empowered without resort to the subpoena process to direct the appearance of any person employed or associated with any member or member organization of the New York Stock Exchange, Inc. and/or the production of any records in the possession or control of such persons, members or member organizations. Unless the arbitrators direct otherwise, the party requesting the appearance of a person or the production of documents under this section shall bear all reasonable costs of such appearance and/or production.]

Succeeding rules will be renumbered.

[Rule 638. EXCHANGE OF DOCUMENTS

At least ten days prior to the date assigned for a hearing, the parties shall exchange documents in their possession which they intend to introduce to the arbitrators. The arbitrators may exclude from the arbitration any document not so exchanged.]

Rule 637. REQUIREMENTS WHEN USING PRE-DISPUTE ARBITRATION AGREEMENTS WITH CUSTOMERS

(1) Any pre-dispute arbitration clause shall be highlighted and shall be immediately preceded by the following disclosure language which shall also be highlighted:

(a) Arbitration is final and binding on the parties.

(b) The parties are waiving their right to seek remedies in court, including the right to jury trial.

(c) Pre-arbitration discovery is generally more limited than and different from court proceedings.

(d) The arbitrators' award is not required to include factual findings or legal reasoning and any party's right to appeal or to seek modification of rulings by the arbitrators is strictly limited.

(e) The panel of arbitrators will typically include a minority of arbitrators who were or are affiliated with the securities industry.

(2) Immediately preceding the signature line, there shall be a statement that the agreement contains a pre-dispute arbitration clause.

(3) A copy of the agreement containing any such clause shall be given to the customer who shall acknowledge receipt thereof on the agreement or on a separate document.

(4) No agreement shall include any condition which limits or contradicts the rules of any self-regulatory organization or limits the ability of a party to file any claim in arbitration or limits the ability of the arbitrators to make any award.

(5) The requirements of this section shall apply only to new agreements signed by an existing or new customer of a member or member organization after _____.

NEW YORK STOCK EXCHANGE, INC.

GUIDELINES FOR CLASSIFICATION OF ARBITRATORS

In order to insure continued investor confidence in the arbitration process, the New York Stock Exchange has adopted the following policies with regard to the classification of securities industry and public arbitrators and to the exercise of challenges for cause:

1. Individuals with close securities industry ties such as attorneys, accountants or other professionals who routinely represent industry firms or individuals, will either be reclassified as industry arbitrators or not be used.
2. Individuals who have spent a substantial part of their business careers in the securities industry shall always be classified as industry arbitrators.
3. Individuals who have spent a relatively minor portion of their career in the securities industry shall not be classified as public arbitrators until at least five (5) years have elapsed from the date of their last industry affiliation. All such past affiliations shall be disclosed and challenges for cause based upon such past affiliations shall be sustained.
4. Close family relationships with broker/dealers shall be disclosed and challenges for cause based on such relationships shall be honored.
5. Attorneys, accountants and other professionals whose firms have close securities industry ties will still be classified as public arbitrators provided the attorney or other professional does not routinely represent industry firms or individuals. Challenges for cause based on such industry ties will be honored.
6. All arbitrators shall read and become familiar with the Code of Ethics for Arbitrators developed by the American Bar Association and the American Arbitration Association.

7. Any close question on arbitrator classification or on challenges for cause shall be decided in favor of public customers.
8. Spouses of securities industry personnel may not serve as arbitrators.

THESE GUIDELINES WILL BE USED BY THE NEW YORK STOCK EXCHANGE IN APPLYING RULE 607.

APPENDIX B

SURVEY TAKEN BY DELOITTE HASKINS & SELLS AT THE REQUEST OF THE NEW YORK STOCK EXCHANGE, INC., OF ARBITRATION AND LITIGATION RESULTS OF CUSTOMER DISPUTES WITH SIX BROKERAGE FIRMS

Deloitte Haskins & Sells

One World Trade Center
New York, New York 10048-0601
(212) 669-5000
International & Domestic Telex
4995706

New York Stock Exchange
11 Wall Street
New York, New York 10005

Attention: Mr. James E. Buck
Senior Vice President and Secretary

Dear Sir:

We have performed the procedures requested by you, as described below, with respect to certain customer originated cases which were terminated either by arbitration, litigation or settlement, as shown in Exhibit A. The procedures that we performed are summarized as follows:

1. We prepared a questionnaire to obtain data from various securities brokerage firms (Exhibit B)
2. We selected six securities brokerage firms with large retail brokerage business and distributed the questionnaires. The six firms were Dean Witter Reynolds Inc., Merrill Lynch, Pierce, Fenner & Smith Inc., Paine Webber Inc., Piper, Jaffray & Hopwood Inc., Shearson Lehman Hutton Inc., and Smith Barney, Harris Upham & Co. Inc.
3. We obtained responses from the firms regarding all cases terminated during a recent three month period. The period

selected was the most recent period for which the firms could obtain data. Such periods were between October 1, 1987 and June 30, 1988.

4. We accumulated the data and prepared Exhibit A based upon the responses received.

Because the information was obtained from securities brokerage firms and was not subjected to procedures in accordance with generally accepted auditing standards, we are not in a position to express an opinion on the data obtained from the firms. However, in our opinion, Exhibit A summarizes fairly the data obtained.

Yours truly,

/s/

DELOITTE HASKINS & SELLS

Exhibit A
Summary of Data Obtained
(dollar amounts shown in thousands)

	Litigated (1)	Arbitrated	Litigation Transferred to Arbitration	All Arbitration
Number of Cases	66	142	35	177
%	27.16%	58.44%	14.40%	72.84%
Average Elapsed Time (days)	599	434	1,056	557
Original Claim:				
Compensatory	8,826	$10,768	$10,333	$21,101
Punitive/Treble	55,075	10,013	10,643	20,656
Total	63,901	20,781	20,976	41,757
Payments: (2)				
Compensatory	1,659	4,057	2,114	6,171
Punitive/Treble	0	10	1	11
Total	1,659	4,067	2,115	6,182
Legal Costs:				
Outside Attorneys	1,018	498	1,392	1,890
Internal Allocations	303	671	348	1,019
Total	1,321	1,169	1,740	2,909
Average Original Claim	968	146	599	236
Average Payment	25	29	60	35
Average Legal Costs	20	8	50	16
Payments as % of Original Claim	2.60%	19.57%	10.08%	14.81%
Legal Costs as % of Payments	79.66%	28.75%	82.75%	47.06%

See Notes to Exhibit A

Notes to Exhibit A

1. One isolated case was omitted because it was considered to bias the remainder of the sample. The impact of this case is as follows (dollar amounts shown in thousands):

	Individual Case	Litigated Totals If Included
Average Elapsed Time (days)	926	604
Original Claim:		
Compensatory	$ 15,000	$ 23,826
Punitive/Treble	100,000	155,075
Total	115,000	178,901
Payments:		
Compensatory	200	1,859
Punitive/Treble	0	0
Total	200	1,859
Legal Costs:		
Outside Attorneys	348	1,366
Internal Allocations	6	309
Total	354	1,675
Average Original Claim	-	2,670
Average Payment	-	28
Average Legal Costs	-	25
Payments as % of Original Claim	.17%	1.04%
Legal Costs as % of Payments	177.00%	90.10%
How Concluded	Settlement	-

2. Total Payments may be categorized as follows (in thousands):

	Litigation	Arbitrated	Litigated Transferred to Arbitration	All Arbitrated
Judgments	$ 174	-	-	-
Arbitration Awards	-	$2,226	$1,317	$3,543
Settlements	1,485	1,841	798	2,639
Total	$1,659	$4,067	$2,115	$6,182

Exhibit B

NEW YORK STOCK EXCHANGE

Case Questionnaire

The New York Stock Exchange is preparing to respond to the Securities and Exchange Commission's request to study arbitration. To assist the Exchange in its preparation please provide the information requested below for certain public customer originated cases. The information should be given for each matter of dispute which was terminated either by arbitration, litigation or settlement during a selected three month period. The period may be selected by you but it should be a recent period. The matter of dispute should be given an identifying number. The names of parties to the dispute need not be given.

1. Case number _____
2. Arbitrated ☐ Litigated ☐ Litigated/Arbitrated ☐
3. If arbitrated:

   NYSE ☐
   NASD ☐
   AAA ☐
   Other _____

4. If litigated please give court or jurisdiction _____
5. Date of original claim _____
6. Amount of original claim:

   Compensatory _____
   Punitive/Treble _____

7. Date matter was concluded _____
8. How concluded:

   Arbitration Award ☐
   Judgment ☐
   Settlement ☐
   Other _____

9. Amount of Award, Judgment or Settlement:

   Compensatory _____

   Punitive/Treble _____

10. Costs of processing the dispute:

   A. Fees of outside counsel _____

   B. Allocated cost of internal legal department _____

Please send the completed information for your firm to Deloitte Haskins & Sells, One World Trade Center, New York, New York 10048-0601, Attention of Edward Lill no later than **September 23, 1988**. For questions relating to your response please call Edward Lill at Deloitte Haskins & Sells (212) 669-5083.